

## Inventory Loss Exclusion\*

D.M. Studler  
Dolores Parr\*

This Chapter addresses the history and evolution of the “inventory loss” exclusion. Three typical exclusions can be found on the 1990 edition of the Employee Dishonesty Coverage Form,<sup>1</sup> the 2002 Commercial Crime Policy<sup>2</sup> (in both the loss sustained and discovery forms) and the 2000 Crime Protection Policy.<sup>3</sup>

1. ISO (Insurance Services Offices) Policy CR 00 01 10 90 (D)(1)(b) (Employee Dishonesty Form)

**D. ADDITIONAL EXCLUSIONS, CONDITION AND DEFINITIONS: In addition to the provisions in the Crime General Provisions Form, this Coverage Form is subject to the following:**

1. **Additional Exclusions: We will not pay for loss as specified below:**
  - b. **Inventory Shortages: loss, or that part of any loss, the proof of which as to its existence or amount is dependent upon:**
    - (1) **An inventory computation; or**
    - (2) **A profit and loss computation.**

2. 2002 ISO Loss Sustained Policy (CR 00 23 07 02 (D)(2)(b))

---

\* By D.M. Studler, Managing Member of Studler, Doyle & Company, and Dolores Parr, Vice President and Managing Counsel, Zurich North America.

<sup>1</sup>Form CR 00 01 10 90 (Sur. Ass’n of Am. 1997), *reprinted in* COMMERCIAL CRIME POLICY 725 (Randall I. Marmor & John J. Tomaine eds., 2d ed. 2005).

<sup>2</sup>Form CR 00 22 07 02 (ISO Properties, Inc. 2001) (Discovery) & Form CR 00 23 07 02 (ISO Properties, Inc. 2001) (Loss Sustained), *reprinted in* COMMERCIAL CRIME POLICY 691 & 703 (Randall I. Marmor & John J. Tomaine eds., 2d ed. 2005).

<sup>3</sup> Crime Protection Policy (2000), *reprinted in* COMMERCIAL CRIME POLICY 677 (Randall I. Marmor & John J. Tomaine eds., 2d ed. 2005).

**D. Exclusions**

**2. Insuring Agreement A.1. does not apply to:**

**b. Inventory Shortages**

**Loss, or that part of any loss, the proof of which as to its existence or amount is dependent upon:**

- (1) An inventory computation; or**
- (2) A profit and loss computation.**

**However, where you establish wholly apart from such computations that you have sustained a loss, then you may offer your inventory records and actual physical count of inventory in support of the amount of loss claimed.**

**3. 2002 ISO Loss Sustained Policy (CR 00 23 07 02 (D)(3)(a) (Accounting or Arithmetical Errors))**

**D. Exclusions**

**3. Insuring Agreements A.3, A.4 and A.5 do not apply to:**

**a. Accounting Or Arithmetical Errors Or Omissions**

**Loss resulting from accounting or arithmetical errors or omissions.**

**4. Surety Association of America Policy, Crime Protection Policy, Sections (E)(2) & (3) (as applicable to specific insuring agreements)**

**D. EXCLUSIONS Applicable to All Insuring Agreements, Except as Indicated**

**We will not pay for loss as specified below:**

**Applicable to Specific Insuring Agreements**

**We will not pay for loss as specified below:**

**1. Under Insuring Agreement 1  
Employee Canceled Under Prior  
Insurance**

**Loss caused by any employee of yours, or predecessor in interest of yours, for whom similar prior insurance has been canceled and not reinstated since the last such cancellation.**

**2. Under Insuring Agreements 1 and 5  
Inventory Shortages**

**Loss, or that part of any loss, the proof of which as to its existence or amount is dependent upon:**

- a. An inventory computation; or**
- b. A profit and loss computation.**

**3. Under Insuring Agreements 3 and 4**

- a. Accounting or Arithmetical Errors or Omissions**  
**Loss resulting from accounting or arithmetical errors or omissions.**

COMMENT

A. Historical Review of the Inventory Shortage Exclusion

Fidelity losses are frequently discovered when:

1. An employer becomes aware of a minor act of employee theft or employee dishonesty. The employer then undertakes an inventory count or profit and loss analysis. The employer presents the employee theft or employee dishonesty claim based upon maximum possible loss calculated by inventory count or profit and loss computation.
2. An employer, conducting a periodic inventory or preparing a profit and loss statement, notes a significant difference between the inventory amount calculated and the amount counted or a significant decrease in profits. Based upon the differences not explained by market factors or other reasons, the employer looks at employees as the only remaining plausible cause. Again, the employer submits the maximum amount as the claimed loss.

Until 1957, the following language was used in an effort by carriers to describe the type of losses that they intended to cover. Fidelity losses were covered “. . . including that part of any inventory shortage which the Assured shall conclusively prove to have been caused by the fraud or dishonesty of any Employees . . . .”

Courts, however, began to construe the term “conclusively” broadly to mean by a preponderance of the evidence, thus resulting in unexpected adverse verdicts to surety companies. Because this provision was found to be inadequate, in 1957, the Surety Association revised the exclusion clause. Set forth in its entirety, the inventory exclusion provided:

**Section 2: This Policy does not apply:**

- (B) . . . to loss, or that part of any loss, as the case may be, the proof of which either as to its factual existence or as to its amount, is dependent upon an inventory computation or a profit and loss computation; provided, however, that this paragraph shall not apply to loss of Money, Securities or other property which the insured can prove, through evidence wholly apart from such computations, if sustained by the insured through any fraudulent or dishonest act or acts committed by any one or more of the Employees. SAA CDDD P-Form A, March 1980.**

As litigation became more frequent over the exclusion introduced in 1957, two lines of authority developed. One held that the exclusion operated to eliminate *any* use of such computations unless other evidence wholly apart from those computations verified the nature and extent of loss. The second line argued that the “proviso” operated to allow the use of such computations so long as there was *some* independent evidence relating to nature and extent of loss.

Despite the fact that this provision has been subject to considerable debate concerning alleged ambiguities, it remained an industry standard until 1977, when, subject to a split of judicial authority over the meaning of the latter half of the clause (beginning “provided however . . .”), the industry moved to clarify further its intent, by deleting the “provided” clause in its entirety.

The 1977 revision provided, as follows:

**Section 2: This Bond does not apply.**

- (B) To loss, or that part of any loss as the case may be, the proof of which either as to its factual existence or to its amount, is dependent upon an inventory computation or a profit and loss computation.**

In 1986, Commercial Crime Policy was introduced. Although the language of the inventory exclusion was revised, the exclusion is similar to the 1977 language:

**COMMERCIAL CRIME POLICY:**

**1. Additional Exclusions: We will not pay for loss as specified below:**

- b. Inventory Shortages: loss, or that part of any loss, the proof of which as to its existence or amount is dependent upon:**
- (1) An inventory computation; or**
  - (2) A profit and loss computation.**

## *Inventory Loss Exclusion*

### B. Current Status of the Inventory Exclusion.

The CR 00 01 10 90 – Form A Employee Dishonesty was one of a number of crime coverage forms available to be combined with Crime General Provision Form CR 10 00 to create a monoline commercial crime policy. Other crime forms available would include Form B – Forgery or Alteration or Form F – Computer Fraud.

The prior forms issued jointly supported ISO and SAA coverage forms. By using individual forms for coverages, the exclusions applicable to a coverage, such as an inventory shortage, were within the individual form for Employee Dishonesty. The inventory shortage exclusion is not listed on the Form B, as an inventory shortage would not result from Forgery or Alteration.

The 2002 ISO Commercial Crime Policy was one of ten forms and policies in the ISO New Crime program introduced in 2000. The ISO Crime policies and forms contain seven insuring agreements. The ISO Crime Program requires fewer forms and endorsements than the jointly supported ISO and SAA coverage forms.

The exclusions in the ISO forms indicate to which insuring agreements they are applicable. The inventory shortage exclusion that applies to Employee Theft coverage under the ISO Program allows the insured to offer inventory information to support the amount of loss if the insured establishes that a loss has occurred without reliance on the inventory information.

### C. Difference in the Exclusion Language between the SAA Employee Dishonesty Form (CR 00 01 10 90):

- b. Inventory Shortages: loss, or that part of any loss, the proof of which as to its existence or amount is dependent upon:**
  - (1) An inventory computation; or**
  - (2) A profit and loss computation.**

and the ISO Policy (CR 00 23 07 02):

- b. Inventory Shortages**  
**Loss, or that part of any loss, the proof of which as to its existence or amount is dependent upon:**
  - (1) An inventory computation; or**
  - (2) A profit and loss computation.**

**However, where you establish wholly apart from such computations that you have sustained a loss, then you may offer your inventory records and actual physical count of inventory in support of the amount of loss claimed.**

## *Inventory Loss Exclusion*

The ISO inventory shortage exclusion that applies to Employee Theft coverage allows the insured to offer inventory information to support the amount of a loss if the insured establishes, without reliance on the inventory computation information, a loss has occurred. The ISO language appears to deny the use of sales and cost of goods sold records to support use of a profit and loss computation, even though the insured may have established, wholly apart from a profit and loss computation, an employee theft loss.

From an accounting perspective, an insured who has discovered a loss through investigating a decrease in sales or decrease in profits, will need to use some other method, wholly apart from its profit calculation, to document and support the evidence of Employee Theft and the amount of Employee Theft. For example, the profit margin of the produce department of a grocery store has been decreasing. Even if the insured can evidence a theft by an employee by providing witness affidavits or video, the insured cannot utilize the loss of profit margin to determine the amount of loss that it sustained due to Employee Theft. Under the ISO form, the insured must present inventory records and actual physical count of the inventory in support of its claim. No longer can the insured contend there is an overall inventory shortage in the produce department; rather the insured must provide the actual physical count sheets of apples, oranges, pears, et al. The insured must also provide the inventory records of the products.

The exclusion in the SAA form is broader than the exclusion contained in the current ISO form. In theory, at least, any claim in which an insured relies on an inventory or profit and loss computation to support its claim is excluded under the SAA form.

### **OUTLINE OF ANNOTATIONS**

Over time, three different solutions have evolved with regard use of inventory or profit and loss computation to establish or support a claim for loss resulting from employee dishonesty:

- A. Exclusion of loss dependent as to its existence or amount on an inventory computation or a profit and loss computation (Absolute Exclusion) (Decisions Upholding Exclusions)
- B. Exclusion of inventory and profit and loss computations with an exception for loss that the insured can prove by evidence wholly apart from such computation was sustained through fraudulent or dishonest acts by an employee (Exclusion With Exception)
- C. A requirement in the insuring agreement that there must be conclusive proof that the loss was due to employee dishonesty if the loss involved a shortage of inventory (Conclusive Proof Standard)<sup>4</sup>

---

<sup>4</sup> Ronald G. Mund & D.M. Studler, *The Inventory Computation & Profit & Loss Exclusion: Separating the Wheat from the Chaff*, VII FID. L J. 7 (Oct. 2001).

## ANNOTATIONS

### **A. Exclusion of a loss dependent as to its existence or amount on an inventory computation or a profit and loss computation (Absolute Exclusion) (Decisions Upholding Exclusions)**

#### **(1) Commercial Crime Policies**

**Ill. App. 1999.** Insured determined that 439 canisters of Freon, valued at \$83,584.80, were missing and that the loss resulted from employee dishonesty. The two-foot high, 30-pound Freon canisters are stored in a locked "cage"--a 20-foot by 10-foot section of the building, fenced off by a 10-foot to 12-foot high chain link fence, open at the top. The court held that there was no evidence of employee dishonesty and that even if the computations do not fall within the inventory shortages exclusion and that the missing Freon was due to employee dishonesty, insured failed to present any evidence as to the number of occurrences and which occurrences, if any, are in excess of the deductible. *Reedy Indus., Inc. v. Hartford Ins.*, 715 N.E.2d 728.

#### **(2) Other Policy or Bond Forms**

**2d Cir. 1973 (NY).** Insured submitted inventory computation to support its claims for loss due to employee dishonesty. The insured had no evidence of employee dishonesty except by negative inference. The court held that an inventory shortage alone is not sufficient to show employee dishonesty. *Dunlop Tire & Rubber Corp. v. Fid. & Dep. Co. of Md.*, 479 F.2d 1243.

**7th Cir. 1966 (Ill.).** Action by assignee to recover upon an employee fidelity bond. In response to plaintiff's argument that the inventory profit and loss exclusion was ambiguous and would tend to make the whole contract illusory, the court held that despite its sympathy with plaintiff's argument, it must be rejected in view of the plain and unambiguous language of the policy. *Gillette Co. v. Travelers Indem. Co.*, 365 F.2d 7.

**10th Cir. 1986 (Wyo.).** Insurer was awarded declaratory judgment that: coverage did not apply; no breach of duty of good faith resulted from insurer's failure to reveal clear and unambiguous limit; insurer had no duty to investigate when it was clearly not liable. The appellate court affirmed the decision, stating that both the fact and the amount of the loss must be shown by independent evidence as the policy required. Independent evidence of the fact that employee stole inventory and cash was not enough when there was no independent evidence of the amount of the theft. *Sec. Ins. Co. of Hartford v. Wilson*, 800 F.2d 232.

### *Inventory Loss Exclusion*

**N.D. Ill. 1986.** Insurer sought summary judgment based on inventory computation exclusion action brought by plaintiff alleging insurer's bad faith in refusal to pay claim of losses resulting from employee dishonesty. Plaintiff presented inventory computation as proof of loss; however, insurer refused to pay claim, since such proof was expressly excluded under the policy. The court held that while the exclusion clause might be subject to eventual judicial interpretation, nevertheless the validity of the clause was supported by case law. Thus, the court concluded that the insurer was entitled to reject inventory computation as proof of loss, at least pending judicial decision on the clause. *Barr Co. v. Safeco Ins. Co. of Am.*, No. 83-C-2711.

**D. Nev. 1968.** Action to recover on two fidelity bonds brought by gambling casino. The court held that a preponderance of the evidence showed that while computation of percentage of win from a game and calculation of an unusually low percentage of win are reliable indicia for the guidance of management and a probable indication that something may be wrong, they were not reliable proof of loss due to employee dishonesty for the reason that too many variables existed. *Mapes Casino, Inc. v. Md. Cas. Co.*, 290 F. Supp. 186.

**S.D.N.Y. 1974.** Plaintiff claimed a loss of over six tons of gold and silver valued at \$395,000. Proof of loss included inventory computations, verified proof that one of several accused employees had been arrested with one bar of silver in his possession and circumstantial evidence relating to several other employees. The court denied recovery based upon the policy exclusion, holding that although plaintiff presented some evidence other than inventory computations to prove employee dishonesty, the court was not persuaded that plaintiff had made a prima facie case as to the existence of any loss other than through the inventory computations. *U. S. Smelting Refining & Mining Co. v. Aetna Cas. & Sur. Co.*, 372 F. Supp. 489.

**E.D. Pa. 1971.** Action in court which denied recovery based upon plaintiff's failure to establish damages through use of negative inference. Plaintiff had presented a claim for loss of roofing shingles from its locked warehouse. As evidence of loss through employee dishonesty, plaintiff offered evidence tending to show that only its employees had access and opportunity to abscond with the missing property. The court held, however, that such evidence of employee dishonesty presupposes the factual existence of the loss and adds nothing by which its existence can be proved. The computations alone, even if accurate, were insufficient to prove the existence of the loss and support a claim under policy exclusion 2(B). *York Lumber Co., Inc. v. Fid. & Dep. Co. of Md.*, 331 F. Supp. 1131.

**Cal. App. 1977.** Textile distributor procured policy of employee fidelity insurance after becoming aware of extensive inventory losses over a one-two year period. The losses continued despite a tightening of security measures and plaintiff sought recovery under the policy. Insurer refused to pay, claiming that inventory exclusion barred recovery. The court agreed, noting that although there was verified proof of employee dishonesty for the period prior to the contract execution date, only inventory computation was available for the period upon which recovery was sought. *Prager & Bear, Inc. v. Fed. Ins. Co.*, 136 Cal. Rptr. 340.



## *Inventory Loss Exclusion*

**Miss. 1966.** Action by warehouse for shortage shown through inventory to amount to \$13,671.15 following time of hiring of the only two employees having access to the warehouse other than the insured's president. Insured also provided evidence that one of said employees sold one of the missing items and accepted a purchaser's check for \$1,010 and appropriated the same to his own use. The court held, however, that comprehensive dishonesty, disappearance and destruction policy excluded recovery for any loss dependent for proof, either as to factual existence or amount, upon inventory or profit and loss computation. *Gotcher Engineering & Mfr. Co., Inc. v. USF&G*, 193 So.2d 115.

**Mo. 1966.** Action in which court held that where bond specifically provided that it would not cover any loss, or part of loss, proof of which either as to its factual existence or as to its amount was dependent on inventory computation, neither audit nor testimony of results of audit, insofar as related to beer shortage at plaintiff's warehouse, was competent evidence to establish liability under bond for shortage. *Locke Distr. Co. v. Hartford Acc. & Indem. Co.*, 407 S.W.2d 658.

**Neb. 1988.** Unexplained shortages of gasoline at various stations were only provable by the taking of inventory and, therefore, properly excluded under "all-risk" policy. The difference between the perpetual records kept by the company and the physical inventory taken was the only proof of the loss. The court noted that there was no independent corroborating evidence, so the inventory exclusion clause must be enforced. *Jones v. Employers Mut. Cas. Co.*, 432 N.W.2d 535.

**Neb. 1968.** Action in a blanket crime policy to recover for property loss allegedly due to employee dishonesty. Plaintiff had knowledge of two thefts by employees and the merchandise lost as a result of those thefts was all recovered. Plaintiff sought, however, to recover for greater loss based upon inventory computations. The court held that insured under fidelity policy containing exclusionary clause in effect restricting recovery to losses in regard to which proof was not dependent upon an inventory computation or profit and loss computation in absence of other evidence, was precluded from recovery for all losses revealed by the inventory computation despite the showing of certain specific losses due to employee dishonesty. *Paramount Paper Prods. Co., Inc. v. Aetna Cas. & Sur. Co.*, 157 N.W.2d 763.

**N.Y. App. 1981.** Dress manufacturer sought recovery for lost inventory. It offered for evidence the apprehension of a company employee in the possession of a small quantity of dresses alleged to be part of the larger total loss. In addition, plaintiff sought to use inventory computations and a financial book audit to establish the extent of loss. The court denied recovery, although acknowledging that the majority view provides for the use of such computations as corroborative evidence, but held under the insufficiency theory that proof of a \$20 loss would not sustain a claim for an over \$15,000 total loss. Under the old clause (1957), jury verdict for plaintiffs of \$15,209 was reversed on appeal because the only independent evidence offered by the employer was discovering \$20

## *Inventory Loss Exclusion*

worth of stolen merchandise in employee's possession. *Teviro Casuals, Inc. v. Am. Home Assur. Co.*, 439 N.Y.S.2d 145.

**N.Y. App. 1977.** Under the old clause, appellate court affirmed judgment of trial court, which awarded employer \$125 of \$123,000 claim. Although employee admitted to stealing \$1,600 worth of goods, those goods were returned to employer. Policy exclusion for losses only ascertainable by profit and loss or inventory computation was valid. This court adheres to public policy argument that positive proof of minor loss would not in itself be sufficient, independent evidence to avoid the exclusion where claim consists of a much larger sum. *Am. Thermostat Corp. v. Aetna Cas. & Sur. Co.*, 399 N.Y.S.2d 292.

**N.C. App. 1987.** Under an all risks policy, insured business could not recover for losses disclosed in taking of regular monthly inventory of available store stock, given policy exclusion for losses due to unexplained or mysterious disappearance of property or shortage of property disclosed on taking inventory. *Blue Stripe, Inc. v. U. S. Fid. & Guar. Co.*, 360 S.E.2d 140.

**R.I. 1970.** Plaintiff brought action to recover under comprehensive dishonesty, disappearance and destruction policy after it caught one of its 80 employees in possession of thirty bars of white metal. This was alleged to be sufficient proof of a larger loss, corroborated by an independent inventory computation. The court disallowed the claim, basing its decision upon the policy exclusion. *Danal Jewelry Co. v. Fireman's Fund Ins. Co.*, 264 A.2d 320.

**B. Exclusion of inventory and profit and loss computations with an exception for loss that the insured can prove by evidence wholly apart from such computation was sustained through fraudulent or dishonest acts by an employee (Exclusion With Exception)**

### **(1) Commercial Crime Policies**

**N.D. III. 1996.** In denying cross motions for summary judgment, the court read the inventory exclusion to exclude only losses the proof of which, as to factual existence or amount, turns upon probabilities deduced or estimations made from comparison of post-theft-discovery dollar, as distinct from unit, inventory amounts with a pre-discovery dollar amount, or of a post-theft unit number with a pre-theft number calculated from a pre-heft dollar inventory amount, but not to exclude a loss which can be established by showing that a particular item or unit of goods observed and identified as present at one physical inventory count is not present at the next. *Blitz Corp. v. Hanover Ins. Co.*, 1996 WL 308233 (1996).

## *Inventory Loss Exclusion*

**N.Y. 1995.** Insured discovered a substantial shortage of merchandise in the clothing department of one of the university book stores. Insured determined that its general merchandise buyer had falsified order forms, invoices, and shipping and receiving documents for items purchased from a vendor and concluded that its employee and vendor had acted together in a scheme to bill insured for merchandise never received. Insured determined that its loss was more than \$1.6 million. In denying the claim, insurer did not rely on the inventory exclusion. The court held that the inventory exclusion could apply if plaintiff did not establish as a matter of law that it could prove the *amount* of its loss by other than dollar estimates. *New York Univ. v. Cont'l Ins. Co.*, 639 N.Y.S.2d 283.

**Pa. Super 1991.** Insured had evidence that employees were stealing video tapes and based the amount of its claim for loss due to employee dishonesty on both an inventory and profit and loss computation. The court held that an inventory computation, and profit and loss computation may be considered to substantiate an insured's claim when independent evidence of the theft has been presented. *Movie Distr. Liquidating Trust v. Reliance Ins. Co.*, 595 A.2d 1302.

**Tenn. App. 1995.** Evidence showing that individual items were received for sale, that they were missing, and that they were not sold was not proof of loss via "inventory computation" such as would result in application of policy exclusion. *Strings & Things in Memphis, Inc. v. State Auto Ins. Cos.*, 920 S.W.2d.

### **(2) Other Policy or Bond Forms**

**11th Cir. 1984 (Ga.).** Employer alleged former vice president had converted construction materials. Trial court's directed verdict was reversed on appeal. The appellate court found that sufficient evidence existed in addition to inventory computation to avoid application of the pre-1977 exclusion clause. This other evidence included purchase orders, invoices (goods never delivered or to wrong site), monthly statements, canceled checks, building plans, job specifications, bid estimates, and independent witnesses. *Fid. & Dep. Co. of Md. v. S. Utilities, Inc.*, 726 F.2d 692, *aff'g* 555 F. Supp. 206 (M.D. Ga. 1983).

**Ariz. 1977.** Action on fidelity insurance policy. The court held that under exclusionary clause of policy prohibiting recovery for losses if proof was dependent upon inventory computation or profit and loss computation, once plaintiff made prima facie showing, other than through inventory computation or profit and loss computation, that some loss occurred which was causally related to insured misconduct by one or more of its employees, insured would be entitled to introduce inventory computations and profit and loss computations to corroborate the loss and prove the total amount. *J. R. Norton Co. v. Fireman's Fund Ins. Co.*, 569 P.2d 857.

**Ga. 1973.** Action in which court allows inventory-type computations to support other evidence which would, on its own, be insufficient. The court's decision relies in part, upon the proviso language deleted from the 1977 standard exclusion. The case appears relevant however, in light of the court's liberal attempt to construe the exclusion to reach

### *Inventory Loss Exclusion*

a desired result. In what has been called the redefining theory, the court simply changed the name of what would normally be considered an inventory-type computation, thereby avoiding the effects of the exclusion. In this case, the court considered that a computation by means of daily sales tickets was distinguishable from standard inventory or profit or loss computations. *Atlanta Coca-Cola Bottling Co. v. Transamerica Ins. Co.*, 61 F.R.D. 120.

**Mass. 1976.** Another decision in which the court adopts the redefining theory to avoid the policy exclusion. In this case, plaintiff's evidence consisted of testimony by a materials control manager to the effect that he put goods in a locked warehouse and later found them to be missing. The court upheld coverage and supported its decision with the following analogy: "If the owner of an automobile locks it in a garage and later finds the garage empty, it would be an unwarranted strain on the language to say that he had made an 'inventory computation.' The dollar amount of loss was computed, not from inventory records but from purchase records." *Popeo v. Liberty Mut. Ins. Co.*, 343 N.E.2d 417.

**Mich. 1975.** Action brought by restaurant owner to recover under fidelity insurance policy. The court held evidence showing that customers paid restaurant bills which were not marked as paid and that restaurant manager took money from cash register without leaving a receipt constituted evidence of restaurant manager's dishonesty, independent of evidence of inventory and/or profit and loss computations, so that evidence of such computations was admissible despite exclusion in policy precluding recovery if proof depended upon inventory or profit and loss computations alone. *NIB Foods, Inc. v. Ins. Co. of N. Am.*, 234 N.W.2d 725.

**Mo. 1977.** Another decision in which the court employed the redefining theory to provide employee dishonesty coverage under a blanket crime policy. The action was initiated by a laundry and dry cleaning business which claimed a loss of \$7,659.47 in cash which was allegedly brought about by the dishonest and fraudulent acts of its employees in failing to remit to plaintiff money collected from customers. The court held that an audit report which determined the amount of the insured's loss by totaling individual cleaning charges shown on computer cards for which a check of the clothing on the racks revealed there was no item of clothing with the corresponding number, did not constitute proof of loss by inventory computation within the meaning of that term as used in the fidelity policy exclusion. *Chenoweth-Chapman Corp. v. Am. Ins. Co.*, 553 S.W.2d 872.

**Mo. 1968.** The court held that the inventory exclusion, which provided that it should not apply to loss which insured could prove through evidence wholly apart from such computation was ambiguous and thus could not be construed to exclude insurer's liability to insured who could prove amount of loss only by resort to inventory computation or profit and loss computation. *Meyer Ins. Co. v. General Ins. Co. of Am.*, 422 S.W.2d 617.

**N.J. 1967.** Decision in which court relied upon public policy rationale to support coverage despite the use of inventory computations. The court held that denial of right to adduce proof of inventory records as either the only available proof of the full amount of

## *Inventory Loss Exclusion*

loss or as corroboration sufficient to make a case where independent proof existed, would defeat justice by precluding recovery on a meritorious claim by use of the only proofs reasonably available to the insured. “So to do would contravene public policy, not only in defeating the reasonable expectations of coverage of the purchaser of the insurance but also in allowing a private agreement to nullify the inherently probative effect of relevant evidence.” *Hoboken Camera Center, Inc. v. Hartford Acc. & Indem. Co.*, 226 A.2d 439.

**N.Y. App. 1983.** Court affirmed judgment for the insured, allowing use of inventory computations as corroborative evidence in case addressing the 1977 form policy exclusion. The theft of cable products by warehouse manager was sufficiently illustrated by testimony of company secretary and inventory records to avoid summary judgment under the inventory exclusion clause. “[I]nventory computation’ is to be construed to proscribe proof of the fact or amount of loss through a generalized estimate, calculated, for example, from sales records and average markup, of what the dollar value of inventory on hand should be. It does not, however, preclude proof of the fact or amount of loss through inventory records (whether perpetual or [periodically made] detailing the actual physical count of individually identifiable units such as are described in the . . . affidavits.” *Ace Wire & Cable Co., Inc. v. Aetna Cas. & Sur. Co.*, 454 N.Y.S.2d 897 (N.Y. 1982), *aff’d*, 457 N.E.2d 761.

**Tenn. App. 2005.** The court held that an inventory exclusion clause in an all-risk insurance policy was limited to cases in which the insured sought to establish a loss only by comparing inventory calculations. Here, a genuine issue of material fact as to whether provider had evidence besides inventory calculations to establish the inventory loss precluded summary judgment on issue of whether coverage for the loss was barred by inventory exclusion clauses in the all-risk policies. This decision contains an exhaustive discussion of inventory exclusion cases. *HCA, Inc. v. Am. Protection Ins. Co.*, 174 S.W.3d 184.

**Wash. App. 1990.** Meat tallow producer paid for supplies based on a yield formula for the final product. When the quality of the raw materials deteriorated, an employee was blackmailed into falsifying records. The appellate court held that, although one method of proof (the inventory records) involved an inventory computation, three other proof methods allowed the Insured to get around the inventory exclusion clause, namely: (1) yields of subsequent deliveries, (2) yield test on last load of supplies, and (3) amount paid versus amount received from all suppliers in 1981. The appellate court affirmed the jury verdict of damages, saying that the terms “fraud and dishonesty,” “intent,” and “result directly” were properly defined; damages were not too uncertain; and attorney fees were properly denied. It appears that the trial court also let the inventory records go into evidence. However, apparently the instruction tendered on this point by the insurer was not sufficient to raise the error, and the court also held that the quantum of other evidence was such that this would not work a reversal. Presumably this was on the theory that if it was error, it was harmless error under the circumstances of this case. *Hanson PLC v. Nat’l Union Fire Ins. Co. of Pittsburgh, Pa.* 894 P.2d 66.

## *Inventory Loss Exclusion*

**Wis. 1963.** Action in which a franchised automobile dealer sought to recover for stolen parts and accessories under a blanket crime policy. Insured's evidence included signed confessions by one employee and admissions by several other persons allegedly purchasing the stolen goods from that employee. A trial court awarded the insured only \$246 out of a total claimed loss of over \$14,000. On appeal, the Supreme Court of Wisconsin acknowledged that inventory computations which had been excluded by the trial court should have been admitted to aid in the establishment of the total loss. The court affirmed the \$246 verdict, however, holding that even if the computations were admitted, the loss remained so speculative as to eliminate the larger claim from jury consideration. *Tri-Motors Sales, Inc. v. Travelers Indem. Co.*, 119 N.W.2d 327.

**C. A requirement in the insuring agreement that there must be conclusive proof that the loss was due to employee dishonesty if the loss involved a shortage of inventory (Conclusive Proof Standard)**

**(1) Commercial Crime Policies**

None.

**(2) Other Policy or Bond Forms**

**Ariz. App. 1977.** The appellate court granted a new trial based on the fact that mismanagement by a feedlot manager could constitute dishonesty within the meaning of the fidelity policy in effect. In so doing, the court also determined that after a prima facie showing through means other than inventory computation or profit and loss computation has been made, either of those otherwise prohibited methods may be used to show the extent of the loss. This was under the old clause. *J. R. Norton Co. v. Fireman's Fund Ins. Co.*, 569 P.2d 857.

**Mo. App. 1977.** The trial court judgment, which awarded the Insured \$7,659.47, was affirmed. The Insured supplied sufficient evidence to get around the inventory exclusion clause by showing that an audit had been performed which was admissible as a business record. The audit compared IBM cards against clothing on the dry cleaner's racks to determine that cash was being received by employees and the cash was not being turned over to the business. This was under the old clause. *Chenoweth-Chapman Corp. v. Am. Ins. Co.*, 553 S.W.2d 872.

**N.Y. App. 1983.** The Insurer appealed from denial of summary judgment at trial court. The plaintiffs were entitled to present evidence at trial that may avoid the inventory exclusion clause. It is not clear whether this case is under the new clause or the old clause. *Schenectady Hardware & Elec. Co. v. Hartford Acc. & Indem. Co.*, 464 N.Y.S. 2d 50.

*Inventory Loss Exclusion*

SECONDARY SOURCES

Chelberg, *The Inventory Computation Exclusion—The Latest View*, 15 THE FORUM 930 (Summer 1980).

Annotation, *Construction and effect of clause in fidelity bond or insurance policy excluding from coverage losses proved by 'inventory computation' or 'profit and loss computation,'* 45 A.L.R.4th 1049 (1986).

Cushman, *An Up-To-Date Look at the Inventory Computation Exclusion in Fid. Ins. Policies*, 39 INS. COUNSEL J. 64 (1972).