



## WHEN EMPLOYEES DO A DISHONEST DAY'S WORK

POLICIES HELP EMPLOYERS RECOVER FROM WORKER THEFT AND FRAUD

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Business owners are able to launch, grow, and achieve financial success in their companies largely because of their employees' hard work. Unfortunately, however, the trusted employees upon whom these companies' viability depends are not always honest. They sometimes follow their unscrupulous instincts and commit crimes at work that cause their employers to lose money and allow themselves (or others) to benefit. Fortunately, there are insurance policies which indemnify policyholders for losses caused by employee fraud and dishonesty. But like many types of insurance, their terms, conditions, and exclusions can be as complicated and varied as the perils against which they insure. This article explores the extent of losses covered under common insuring agreement language within an employee dishonesty insurance policy.

Employee dishonesty policies have long indemnified policyholders for actual losses caused by flagrantly dishonest acts, such as theft of valuables from a safe or cash box. They can also cover credit card, fund transfer, and Internet fraud.

One of the earliest crime policy decisions in Connecticut concerns depositors' forgery coverage, and a purchasing agent's use of legitimately signed blank checks to "buy" for his employer's inventory used cars that did not exist. *Baldwin Motors Inc. v. Aetna*, 24 Conn. Supp. 498, 501 (1963). The court in *Baldwin* held that the transactions were covered forgeries. Even though previously

signed by "duly authorized officers," when the dishonest agent inserted the dates he made the checks "completed instruments" which were not "true writing[s]."

Through multiple insuring agreements, a single dishonesty policy can protect the insured against various types of fraudulent or dishonest acts. One of the broadest insuring agreements in such a "comprehensive" dishonesty policy covers "loss of money" that the insured sustains "resulting directly from one or more fraudulent or dishonest acts committed by an Employee, acting alone or in collusion with others." With respect to which fraudulent and dishonest acts are covered, dishonesty policies often indemnify only for those acts which employees commit with the intent: "(a) to cause the insured to sustain a loss; and (b) to obtain financial benefit for the Employee or for any other person or organization intended by the Employee to receive such benefit. . . ." *Leucadia Inc. v. Reliance Insurance Co.*, 864 F.2d 964, 966 (2d Cir. 1988).

Within these two multifaceted provisions, the most important phrase to the policyholder may be "resulting directly from," because it is those three words which may dictate the scope of insurance recovery after fraudulent or dishonest acts have occurred.

### Recovery For Losses

Unfortunately, there are few Connecticut cases interpreting the "resulting directly from" element commonly found in



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the comprehensive dishonesty policy. In 2002, the District Court held that an employee dishonesty policy "unambiguously limits coverage to indemnification of the insured entity for a direct loss" and that the payment of damages to a third party is an "indirect loss" explicitly excluded in the policy. *Finkel v. St. Paul Fire and Marine Insurance Co.*, 2002 U.S. Dist. LEXIS 11581 at \*12; 15 (D. Conn. 2002). In *Finkel*, a payroll service company president misappropriated millions of dollars from customers' trust funds to pay for his gambling debts. The bankruptcy trustee, Richard Finkel, sought to recover the customer losses from St. Paul, the insurer. The court held that the policy's coverage for direct losses precludes indemnification for "consequential or remote damages that might arise out of the employee's conduct."

Decisions like *Finkel*, holding that third parties' losses are indirect losses for which the insurer is not liable, are fairly common. But in the context of a permissible first-party claim, neither the court in *Finkel*, nor any other state or federal court in Connecticut, explains how courts determine whether losses under a dishonesty policy are either

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“direct” or “consequential or remote.”

Irrespective of legal connotations, it is easy to differentiate between the words “direct” and “remote.” But, understandably, when used as adjectives applying to loss or damages, the waters become murky for the policyholder. Furthermore, the term “consequential” in *Finkel* offers no guidance to the insured pondering (or worrying about) what might be a covered loss “resulting directly from” employee dishonesty. Black’s Law Dictionary defines “consequential damages” as “losses that do not flow directly and immediately” from an act. For example, if an employee steals a company computer, the computer’s replacement cost, or at least its “book value,” would be a covered direct loss. However, if the insured slips and falls while buying a replacement computer, those injuries are likely “consequential,” and thus not covered.

Policyholders may be confused about their recovery prospects for losses which seem to fall between the extremes of “di-



## Insurance Litigation

rect” and “consequential.” In our example, an insured might wonder if it will recover payment to a computer consultant it hires to set up the replacement computer. Considering the *Finkel* court’s focus on unrecoverable “consequential or remote damages,” a Connecticut court would likely follow those jurisdictions which apply a “proximate cause test” for recovery under dishonesty policies. Proximate cause is, after all, according to Black’s, “also termed as direct cause.” In *Resolution Trust Corp. v. Fidelity & Deposit Co. of Maryland*, 205 F.3d 615 (3d Cir. 2000), for example, the court held that “the phrase ‘losses resulting directly from’” employee dishonesty (the same language as the policy in *Finkel*) “requires, for purposes of indemnification, that the losses be ‘proximately caused by’ the fraudulent or

dishonest acts of the employee. . . .”

A Connecticut court following the Third Circuit in *Resolution Trust* would likely hold that the policyholder will recover for the computer set up costs and other losses proximately cause by the employee’s dishonesty.

Employee dishonesty insurance policies protect employers against a variety of fraudulent and dishonest acts by their employees, and employers should evaluate their business needs when considering purchasing such a policy or reviewing a policy they already have. However, despite the possibility of direct loss indemnification discussed in this article, employers should not underestimate the importance of pre-hire due diligence which can often detect employees with crime and dishonesty in their pasts. ■