

“Loss Resulting Directly From”: Causation Under The Financial Institution Bond And Similar Insurance Forms

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Nothing is more noble, nothing more venerable than fidelity. Faithfulness and truth are the most sacred excellences and endowments of the human mind. – *Cicero*¹

No man is so exquisitely honest or upright in living, but that ten times in this life he might not lawfully be hanged. – *Montaigne*²

I. Introduction

While Cicero’s musings on the nobility of the faithful may resonate in the personal moral code of most people, Montaigne’s more jaundiced view of human nature may, unfortunately, be closer to the truth. Simply stated, humans are inherently fallible, and some more so than others. Consequently, businesses and financial institutions have been insuring themselves for losses resulting from “fraudulent or unfaithful dealings by employees and certain outside parties”³ even before standard bond forms were introduced in the early 1900s.⁴ More recently, these policies have taken the form of some variation on the Financial Institution Bond,⁵ which specifically addresses the risks faced by financial institutions,⁶ and the Commercial Crime Policy,⁷ which is adaptable to any type of business organization.

¹ Creative Quotations, available at <http://www.creativequotations.com>.

² Michel de Montaigne, quoted in THE QUOTABLE LAWYER, at 129 (David Shrager & Elizabeth Frost eds., 1986).

³ American Cas. Co. v. Etowah Bank, 288 F.3d 1282, 1284 (11th Cir. 2002).

⁴ See Edward G. Gallagher et al., *A Brief History of the Financial Institution Bond*, in FINANCIAL INSTITUTION BONDS 1, 9 (Duncan L. Clore ed., 1998).

⁵ Financial Institution Bond, Standard Form No. 24 (Revised Jan. 1986), reprinted in STANDARD FORMS OF THE SURETY ASSOCIATION OF AMERICA (Surety Ass’n of America 1995) [hereinafter Financial Institution Bond or Bond].

⁶ See generally J. Kelly Reyher, *A Brief Review of the Financial Institution Bond Standard Form No. 24 and Commercial Crime Policy*, 563 PLI/Lit 57 (1997).

⁷ Crime General Provisions Form CR 10 00 0695 (rev’d 1994), reprinted in STANDARD FORMS, *supra* note 5 [hereinafter Commercial Crime Policy].

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From the outset, these standard bond forms have required proof of a causal nexus between the specified covered risk and the insured's alleged loss.⁸ Since approximately 1980, the Financial Institution Bond, its predecessor Bankers Blanket Bond,⁹ and various Commercial Crime Policy forms¹⁰ have articulated this causation requirement by providing that the claimed loss result "directly from" a covered risk.¹¹

As is true of many provisions of these standardized policies,¹² the requirement of "direct" causation has been subjected to considerable judicial scrutiny. While some courts correctly apply proper rules of contractual interpretation to determine whether a loss is direct, others incorrectly apply more expansive tort doctrines.

This article will discuss the causation requirements of the Financial Institution Bond and the standardized crime policies, all of which hereinafter will be referred to collectively as the Financial Institution Bond, unless otherwise specified. This article will first review the distinctive process by which the Bonds have been drafted over time to address a realistic allocation of the risks inherent in business and the financial industry. The article will then focus on the difference between concepts of tort causation used by some courts to interpret the Bond and the actual language of the Bond, evidencing the parties' intent to limit the insurer's liability by using a stricter causal standard of "resulting directly from." Finally, this article will examine the case law on this issue under several of the various insuring agreements.

II. The Purpose of The Bond: To Allocate Risk

This article concerns the interpretation of just three words: "resulting directly from." But to interpret these words properly, it is necessary to consider the whole policy of which they are a part, "with due regard to the risk[s] undertaken, the subject matter that is insured, and the purpose of the entire contract."¹³ To that end, it should be observed that the present form of the Financial Institution Bond has been shaped as a result of the longstanding collaborative efforts of the Surety Association of America and the American Bankers Association.¹⁴ Consequently, courts have rightly recognized the fact that the Financial Institution Bond is a particularized type of insurance policy that was partly drafted by, and widely discussed within, the insured banking industry.¹⁵ Over

⁸ See, e.g., *Piedmont Fed. Sav. & Loan Ass'n v. Hartford Accident & Indem. Co.*, 307 F.2d 310, 315 (4th Cir. 1962) (no forgery coverage for loan losses that savings and loan would have incurred even if the loan documents had not been forged). "The relation of the forgery to the loss is, at most, oblique." *Id.* at 314.

⁹ Appendix, Exhibit 4, Bankers Blanket Bond, Standard Form No. 24, in *FINANCIAL INSTITUTION BONDS*, at 701 (Duncan L. Clore ed., 1998).

¹⁰ Commercial Crime Policy, *supra* note 7.

¹¹ See Gallagher, *supra* note 4, at 28.

¹² The banker's blanket bond has been called the "most litigated contract in the history of western man." 11 *COUCH ON INS.* 3d § 160:1 (1998).

¹³ *First Ins. Funding Corp. v. Federal Ins. Co.*, 284 F.3d 799, 804 (7th Cir. 2002).

¹⁴ Robin V. Weldy, *History of Financial Institution Bonds*, *BANKERS AND OTHER FINANCIAL INSTITUTION BLANKET BONDS* 15-20 (1979).

¹⁵ *Oritani Sav. & Loan Ass'n v. Fidelity & Dep. Co.*, 989 F. 2d 635, 642 (3rd Cir. 1993) ("The banking industry certainly had some bargaining power to effect changes in the language of the bond.").

many years, the parties to the bond have carefully analyzed and then selected specific language to best articulate the coverage to be provided thereby, with an eye to more accurately defining their respective expectations, in light of case law interpreting earlier versions of the bond.¹⁶

A bank or other business entity cannot, as a practical matter, insure itself against all risks inherent in its business.¹⁷ With this reality in mind, the Financial Institution Bond and the commercial crime policies have been drafted to allocate the various risks of loss between insurer and the banking industry or businesses in general, compromising between insuring against certain risks and providing coverage at a reasonable premium.¹⁸ Consequently, it is often stated that this policy is not intended to constitute broad insurance against the risk of loss to the financial institution in its financial banking operations.¹⁹ As becomes evident from reading the case law construing the Bond and articles discussing the evolution of the Bond, the allocation of risks between insured and insurer is reflected in the precise language used in the Insuring Agreements, including the requirement of direct causation, and in the interplay between the various Insuring Agreements and the standard policy exclusions.²⁰

The Financial Institution Bond, from its inception, has been a first-party indemnity contract, in which the insurer agrees to indemnify the insured for losses that the insured sustains as a result of any of the events that the insuring agreements enumerate.²¹ Typically, the Bond provides coverage within at least six categories of risk: (1) fidelity; (2) on premises; (3) in transit; (4) forgery; (5) securities; and (6) counterfeit currency. Commercial crime policies address fewer risks but usually include at least fidelity and forgery.

Since at least 1980,²² each insuring agreement in these policies has been carefully drafted so as to reiterate the fundamental requirement for coverage that the claimed loss “result directly from” the covered conduct enumerated in that insuring agreement. Additionally, the policies typically exclude from coverage any “indirect or consequential

Therefore, there is no basis for construing any arguably ambiguous provision of the bond against the insurer. *See, e.g.,* United States Fire Ins. v. Federal Dep. Ins. Corp., 981 F.2d 850, 851 (5th Cir. 1988); Sharp v. Federal Sav. & Loan Ins. Corp., 858 F.2d 1042, 1044 (5th Cir. 1988); Calcasieu-Marine Nat’l Bank v. American Employers’ Ins. Co., 533 F.2d 290, 296 (5th Cir. 1976); Shearson/American Express, Inc. v. First Cont’l Bank & Trust, 579 F. Supp. 1305, 1311 (W.D. Wis. 1984).

¹⁶ See Gallagher, *supra* note 4, at 21, 30, and throughout his article.

¹⁷ Karen K. Fitzgerald, *The Loan Exclusion: Allocating Business Risks to the Banker*, in FINANCIAL INSTITUTION BONDS at 293 (Duncan L. Clore ed., 1998) (“If it sought such coverage, the premium expense might outweigh the risk of loss.”).

¹⁸ *Id.*

¹⁹ *See, e.g.,* James A. Knox & Karen K. Fitzgerald, *The Loan Exclusion: The Predominant Risk Allocator*, FINANCIAL INSTITUTION BONDS, at 197 (Duncan L. Clore ed., 1995); Larry D. Dingus, *What is Mysterious Unexplainable Disappearance?* VII THE FORUM 113 (1972).

²⁰ *See, e.g.,* Gallagher, *supra* note 4, and cases discussed throughout this paper.

²¹ 11 COUCH ON INS. 3d § 160:7 (1998); American Legion Dep’t, Inc. v. Hanover Ins. Co., 286 B.R. 729 (E.D. Mo. 2002); American Empire Ins. Co. v. Fidelity & Dep. Co., 408 F.2d 72 (5th Cir. 1969). *See also* 11 COUCH ON INS. 3d § 160:1 (1998).

²² *See* Gallagher, *supra* note 4, at 28.

loss of any nature,”²³ as well as “damages of any type for which the Insured is legally liable, except compensatory damages ... arising directly from a loss covered under this bond.”²⁴ These and several other exclusions that preclude coverage for losses “resulting directly” from factors other than the specifically enumerated covered risks reinforce the drafters’ intent to narrow the scope of coverage only to those losses strongly and immediately linked to a covered act.²⁵

III. Does “Directly” Mean Directly?

The parties having carefully crafted the phrase “resulting directly from” and placed it in each of the Insuring Agreements and a number of the exclusions of the Financial Institution Bond, how then should this phrase be construed by a court of law? It is axiomatic that the primary concern of a court asked to interpret an insurance policy should be to give effect to the written expressions of the parties’ intentions.²⁶ Further, when there is no ambiguity in the language, as would seem to be the case in the simple words “resulting directly from,” then “courts must give the words their plain, ordinary and generally accepted meanings.”²⁷ Or, stated otherwise, the wording of the policy should be given effect as written.²⁸ What, then, is the plain meaning of these words?

“Result[ing]” is defined in *The American Heritage Dictionary* as “[t]o come about as a consequence The consequence of a particular action, operation or course.”²⁹ “Directly” is defined as “[i]n a direct line or manner; straight.... Without anyone or anything intervening.... At once, instantly.”³⁰ Taking these definitions together, the plain meaning of “[l]oss resulting directly from” is a loss that is the direct, instant, or immediate, consequence of specified conduct,³¹ without any intervening event or activity.³² “Resulting,” which begins the participial phrase that modifies the word “[l]oss” and which in turn is modified by “directly,” can have no other meaning; and, under commonly accepted principles of contract interpretation, as an unambiguous statement of the intent of the parties as to their expectation of the insurer’s liability, the word “directly” must not be disregarded.

²³ Financial Institution Bond, Exclusion 2(v).

²⁴ Financial Institution Bond, Exclusion 2(t).

²⁵ See John W. Hinchey, *Loss and Causation*, in ANNOTATED BANKERS BLANKET BOND, FIRST SUPPLEMENT 5-6 (Frank L. Skillern, Jr. ed., 1983).

²⁶ See, e.g., *Federal Dep. Ins. Corp. v. Firemen’s Fund Ins. Co.*, 109 F.3d 1084, 1087 (5th Cir. 1997).

²⁷ *Id.*

²⁸ *First Ins. Funding Corp. v. Federal Ins. Co.*, 284 F.3d 799, 804 (7th Cir. 2002).

²⁹ THE AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE 1539 (3d ed. 1992).

³⁰ *Id.* at 527. See also BLACK’S LAW DICTIONARY 413 (5th ed. 1979) (first definition of “direct” is “immediate;” definition of “direct cause” is that which brings about a result without intervention from any independent source).

³¹ See, e.g., *Stop & Shop Cos., Inc., v. Federal Ins. Co.*, 946 F. Supp. 99, 106 (D. Mass. 1996), *aff’d on other grounds*, 136 F.3d 71 (1st Cir. 1998) (finding as a matter of Massachusetts insurance law that “direct loss” under Commercial Crime Policy refers to immediate damage resulting from covered cause and that “directly” equates with “immediately”).

³² See BLACK’S LAW DICTIONARY, *supra* note 30, at 413; William T. Bogaert & Andrew F. Caplan, *Loss and Causation Under the Financial Institution Bond*, in FINANCIAL INSTITUTION BONDS 381, 416 (Duncan L. Clore ed., 1998).

However, as discussed below, some insureds and some courts would like to read the adverb “directly” out of the Bond, imposing a tort law concept of causation on the Bond by arguing that the Bond requires an insured to show only that its losses were “substantially” or proximately caused by a covered risk, or that the covered risk was the “but for” cause of the insured’s loss.³³ In the better-reasoned decisions, such arguments fail in favor of a finding that the insurer’s liability is limited to that provided for by its contract, to losses “directly resulting,” that is, those that flow immediately in time or space, and without any intervening cause,³⁴ from the specified conduct or peril.³⁵

A brief summary of the differences between the concepts of tort causation and contractual liability for damages may be helpful in understanding why the phrase “resulting directly from” requires stronger, more immediate proof of causation than that provided for under tort law.

A. TORT CAUSATION

Tort causation involves two elements: (1) cause-in-fact, also referred to as the “but for” or “*sine qua non*” test; and (2) legal cause, also referred to as “proximate cause” or the “substantial factor” test.³⁶ Courts in Financial Institution Bond coverage cases typically and correctly consider whether both of these elements of causation have been satisfied because, unless an otherwise covered act is both the cause-in-fact *and* the legal cause of a loss, the claim will fail.³⁷ However, as discussed in Section IV of this article, below, satisfaction of the elements of tort causation does not dispose of the additional issue of whether the loss meets the stronger causal relationship required by the “directly resulting from” language of the Financial Institution Bond.

1. Cause-in-Fact

The cause-in-fact or “but-for” test of causation, carried to its logical extreme, has been likened to the expansive chain of causation that Winston Churchill constructed in his history of the First World War:³⁸

[Churchill] began by referring to the fact that in 1920 King Alexander of Greece died by blood poisoning, having been bitten by a pet monkey. This event was followed by a plebiscite, then a new king, and finally a bloody

³³ See, e.g., *Bidwell & Co. v. Nat’l Union Fire Ins. Co.*, No. CV-00-89-HU, 2001 WL 204843, at *9 (D.Or. Jan. 18, 2001); *Mid-America Bank v. American Cas. Co.*, 745 F. Supp. 1480, 1485 (D. Minn. 1990).

³⁴ See, e.g., *Auto Lenders Acceptance Corp. v. Gentilini Ford, Inc.*, 816 A.2d 1068, 1072 (N.J. Super. Ct. App. Div. 2003) (“The policy involved here provides coverage to employers for losses sustained as a direct result of the illegal acts of employees, without any intervening event.”).

³⁵ Bogaert & Caplan, *supra* note 32, at 416.

³⁶ See Hinchey, *supra* note 25, at 5.

³⁷ See, e.g., James J. Moran, Jr. & William T. Bogaert, *Loss and Causation in the Simplified Commercial Crime Forms*, in *FIDELITY BONDS* § M, at 17 (1991).

³⁸ Peter C. Haley, *The Power of Defined Terms and Causation Theories Under Insuring Agreement (E) of the Financial Institution Bond*, 31 *TORT & INS. L.J.* 609 (1996).

war with the Turks. Churchill wrote, "A quarter of a million persons died of that monkey's bite."³⁹

Fidelity insurers would shudder to think that this type of Churchillian, "but-for" causation would apply to their policies. Yet "inventive" insureds have made exactly this type of argument.⁴⁰ For example, in *Continental Corp. v. Aetna Casualty & Surety Co.*,⁴¹ the insured argued that losses resulting from acts of its employees committed after being fired were nevertheless covered acts of employee dishonesty because the losses could not have occurred, under the circumstances of this case, *but for* the fact that the wrongdoers had once been employees.⁴² The Seventh Circuit, in reversing the trial court's finding of coverage, observed as follows: "Only through the most tortuous causal chain could actions of [the ex-employee committed while employed elsewhere] be deemed even marginally relevant to [the insured's] losses."⁴³ As *Continental Corp.* illustrates, "but-for" causation would render meaningless the requirement that the loss "result directly from" a covered risk and allow for coverage even for causes that *indirectly* lead to losses. When "direct" is interpreted to mean the same as "indirect," we have stepped through the looking glass.

2. Legal or Proximate Cause

The "legal cause" element of tort causation requires a plaintiff to prove that the defendant's conduct was also the proximate cause of the harm suffered.⁴⁴ While cause-in-fact relates to the chain of events culminating in a loss (i.e., a monkey bite leads to 250,000 deaths), the proximate cause concept ostensibly narrows the scope of a tortfeasor's legal responsibility by requiring something more.⁴⁵

Proximate cause in this context means that the loss was caused in a direct sequence by the allegedly covered action, unbroken by any independent cause, without which the loss would not have occurred.⁴⁶ Courts that have applied this standard to Financial Institution Bond claims, such as the district court did in *Federal Deposit Insurance Corp. v. Reliance Insurance Corp.*,⁴⁷ consider it to be an "established rule of insurance law" that, where the peril specifically insured against sets other causes in motion which, in an unbroken sequence and connection between the act and the final loss produces the result for which recovery is sought, the insured peril is regarded as the proximate cause of the loss.⁴⁸ As noted by the court in *Auto Lenders Acceptance Corp. v.*

³⁹ *Id.* at 630.

⁴⁰ See *Continental Corp. v. Aetna Cas. & Sur. Co.*, 892 F.2d 540, 546-48 (7th Cir. 1989).

⁴¹ 892 F.2d 540, 548 (7th Cir. 1989).

⁴² *Id.* at 548.

⁴³ *Id.* at 549.

⁴⁴ DAN B. DOBBS, *THE LAW OF TORTS* 405 (West Group 2000).

⁴⁵ *Id.* at 407.

⁴⁶ *Hanson PLC v. Nat'l Union Fire Ins. Co.*, 794 P.2d 66, 73 (Wash. Ct. App. 1990).

⁴⁷ 716 F. Supp. 1001, 1004 (E.D. Ky. 1989).

⁴⁸ *Id.* at 1004. See also *Mid-America Bank v. American Cas. Co.*, 754 F. Supp. 1480, 1485 (D. Minn. 1990) (if a loss is caused by an act that played a substantial part in bringing about the loss and the loss is a reasonably probable consequence of the act, then the act is the proximate cause of the loss).

Gentilini Ford, Inc.,⁴⁹ this rule is also known as the “Appleman’s Rule,” based on certain statements in a chapter on fire insurance in John Alan and Jean Appleman’s *Insurance Law and Practice*, concerning the issue of when it can be said that property has been damaged as a result of fire.⁵⁰ Appleman’s generalization about the coverage afforded by fire insurance makes no mention of the specific policy language being construed and instead bases its analysis on “the reasonable expectation of an ordinary business man in making an ordinary [fire insurance] contract.”⁵¹

The Appleman or tort law causation standard allows for multiple causes, especially along a chain of events across time. “Proximate consequences need not be close in point of time or distance in order to make the defendant liable in tort for the damage caused; they may be remote both in time and distance but still be included in any recovery against the defendant.”⁵² In fact, “proximate cause ... is not about causation at all but about the significance of the defendant’s conduct or the appropriate scope of liability, an issue that entails heavy elements of moral and policy judgment about the very particular facts of the case.”⁵³

The court in *Federal Deposit Insurance Corp. v. Reliance Insurance Corp.*⁵⁴ was partially correct; the concept of proximate causation is an established rule of insurance law, under certain circumstances and types of policies. Consequently, if the drafters of the Bond’s Insuring Agreements and exclusions, they could have done so, especially given the propensity of courts to read that standard into prior versions of the Bond. But they did not. Instead, they replaced the pre-1980 language of the Bond, which stated the causation requirement in the far more general terms of insuring “loss *through*” a covered act, with the very specific requirement of “resulting directly from.” Under rules of contract interpretation, case law relying on generalized principles of insurance and tort law derived from completely different insurance policies and risks, as well as inapplicable public policy considerations, should not be allowed to supersede the intentionally chosen, actual language in the Financial Institution Bond requiring “direct” causation.

B. CONTRACT CAUSATION

When a contract like the Financial Institution Bond forms the basis of the parties’ relationship, the moral and policy judgments of tort law are irrelevant. Rather, principles of contract interpretation determine the scope of the parties’ liability for damages based upon their stated intentions.⁵⁵ Contract damages simply flow from the intention of the

⁴⁹ 816 A.2d 1068 (N.J. Super. Ct. App. Div. 2003).

⁵⁰ JOHN ALAN APPLEMAN & JEAN APPLEMAN, 5 INS. LAW & PRAC. § 3083, at 307-3083 (1970).

⁵¹ *Id.*

⁵² 22 AM. JUR. 2D *Damages* § 477 (2003).

⁵³ DOBBS, *supra* note 44, at 408.

⁵⁴ 716 F. Supp. at 1004.

⁵⁵ *Spearman Indus., Inc. v. St. Paul Fire & Marine Ins. Co.*, 138 F. Supp. 2d 1088 (N.D. Ill. 2001).

parties at the time their agreement was made.⁵⁶ As is simply stated in the comments to section 346, *Restatement (Second) of Contracts*, the parties to a contract may by agreement “vary the rules” concerning their liability for damages.⁵⁷

Additionally, the doctrine of foreseeable consequences limits the scope of a party’s liability for contractual damages.⁵⁸ “Damages are not recoverable for loss that the party in breach did not have reason to foresee as a probable result of the breach when the contract was made.”⁵⁹ Thus, “the requirement of foreseeability is a more severe limitation of liability than is the requirement of substantial or ‘proximate’ cause in the case of an action in tort.”⁶⁰ Williston provides such an example:

Where a seller wrongfully fails to deliver promised goods, the buyer’s damage from the inability to use them for a special profitable purpose it had in mind is a proximate consequence of the breach, but not one that is usual or one that the seller would reasonably expect. The law of torts and contracts differ in this respect. For a tort, the defendant becomes liable for all proximate consequences, while for breach of contract the defendant is liable only for consequences that were reasonably foreseeable, at the time the contract was made, as likely to result if the contract were broken.⁶¹

In addition to considering foreseeability, courts limit the availability of contract damages by looking to the parties’ intentions at the time that they entered the agreement. To ascertain the intention of the parties, courts look to “the language of the contract in light of the facts, including the nature and purposes of the contract.”⁶² Ultimately, “[d]amages which are not foreign to the purpose of the contract ... should be awarded.”⁶³

Applying these principles of contract law, it is proper to construe the “resulting directly from” causation language of the Financial Institution Bond more narrowly than would be required under a proximate cause requirement.⁶⁴ The causation language of the Bond should be interpreted to conform with the purpose of the Bond, namely, to

⁵⁶ 22 AM. JUR. 2D *Damages* § 451 (2003). *See also* Hofstee v. Dow, 36 P.3d 1073 (Wash. Ct. App. 2001) (explaining that contract damages arise from expectations created by agreement).

⁵⁷ RESTATEMENT (SECOND) OF CONTRACTS § 346 cmt. a (1979).

⁵⁸ *See* Vanderbeek v. Vernon Corp., 50 P.3d 866 (Colo. 2002) (discussing foreseeability as element of contract measure of damages).

⁵⁹ RESTATEMENT (SECOND) OF CONTRACTS § 351 (1981).

⁶⁰ RESTATEMENT (SECOND) OF CONTRACTS § 351 cmt. a (1981). *See also* Inchaustegui v. 666 5th Ave. Ltd. P’ship, 706 N.Y.S.2d 396, 400 (App. Div. 2000) (stating that “[w]hile tort damages are expansive, focusing on the full spectrum of the harm caused by the tortfeasor, damages for a breach of contract are restrictive”).

⁶¹ SAMUEL WILLISTON, 24 TREATISE ON THE LAW OF CONTRACTS § 64.13 (4th ed. 1990).

⁶² 22 AM. JUR. 2D *Damages* § 460 (2003).

⁶³ *Id.* *See also* WILLISTON, *supra* note 61, at § 64.13 (4th ed. 1990).

⁶⁴ *See* United Sec. Bank v. Fidelity & Dep. Co., No. 96-16331, 1997 WL 632606 (9th Cir. Sept. 16, 1997) (concluding that “direct loss [under a fidelity bond] is much narrower than proximately caused loss”).

indemnify for losses, resulting immediately,⁶⁵ without any intervening cause,⁶⁶ from a covered risk, that the insured itself⁶⁷ sustains.

IV. How Much Evidence of Causation Is Enough?

A consideration of causation under any policy of indemnity insurance should begin by acknowledging that it is the insured's fundamental burden to prove that a claim against its insurer is within the policy's coverage, by making a prima facie showing that it suffered a loss caused by a covered act.⁶⁸ The recent decision of *Performance Autoplex II Ltd. v. Mid-Continent Casualty Co.*⁶⁹ addresses the sufficiency of an insured's initial burden of proof as to causation. While conducting an annual inventory, an automobile dealership discovered a severe shortfall in its parts department. After investigation, the dealership found that its parts manager had stolen parts and cash from the dealership.⁷⁰ The insured had direct evidence that the parts manager was responsible for roughly half of the total inventory discrepancy in the parts department. The fidelity insurer paid that portion of the claim but refused to pay for the entire inventory loss.⁷¹ The dealership advanced the argument that the parts manager's responsibility for part of the loss "raise[d] the inference that he [was] responsible for the entire loss."⁷² The court was not persuaded and agreed with the insurer, explaining that such inferences were not enough to establish causation and that the dealership had not produced any direct evidence to support its inferences.⁷³

Most causation cases do not concern the question of whether the insured has *any* evidence to prove the causal connection between its loss and a covered act; instead they address the issue of whether the cause-and-effect chain of proof offered by the insured is sufficiently direct. In considering the sufficiency of this proof, numerous courts have correctly interpreted the "resulting directly from" language of the bond.

For example, in *French American Banking Corp. v. Flota Mercante Grancolombiana, S.A.*,⁷⁴ the insured bank attempted to recover losses under Insuring Agreement E⁷⁵ arising from a scheme to defraud the bank into issuing a loan. The bank

⁶⁵ See, e.g., *Lynch Properties, Inc. v. Potomac Ins. Co.*, 962 F. Supp. 956, 961 (N.D. Tex. 1996).

⁶⁶ See, e.g., *Auto Lenders Acceptance Corp. v. Gentilini Ford, Inc.*, 816 A.2d 1068, 1072 (N.J. Super. Ct. App. Div. 2003).

⁶⁷ *Fireman's Fund Ins. Co. v. Special Olympics Int'l, Inc.*, 249 F. Supp. 2d 19, 28 (D. Mass. 2003).

⁶⁸ *Performance Autoplex II Ltd. v. Mid-Continent Cas. Co.*, 322 F.3d 847, 854 (5th Cir. 2003).

⁶⁹ 322 F.2d 847 (5th Cir. 2003).

⁷⁰ *Id.* at 850.

⁷¹ *Id.* at 851.

⁷² *Id.* at 854.

⁷³ *Id.* at 855. *Lipman Bros. v. Hartford Acc. & Indem. Co.*, 149 Me. 199, 216 (1953), provides another, more agrarian example of an insured's unsuccessful attempt to establish a prima facie case of causation by inference. In *Lipman*, the court held that an employee's prior unsuccessful attempt to steal 109 chickens from his employer was insufficient to establish that the employer's subsequent loss of 5,449 chickens was due to employee theft.

⁷⁴ 752 F. Supp. 83 (S.D.N.Y. 1990).

⁷⁵ Insuring Agreement E insured losses directly resulting from the extension of credit on the faith of forged or counterfeit security. 752 F. Supp. at 84, 87-88.

contended that the loss arose out of covered acts because the signatures on certain bills of lading offered as security for the bank's loans were forgeries and the documents themselves were counterfeit.⁷⁶ While unable to find proof of either forgery or counterfeiting, the court stressed that, even had such proof been found, the insurer would still prevail because the losses were not caused directly by the covered acts, but rather resulted from the overall, underlying "fraudulent scheme."⁷⁷ The court noted that, even if the forgery had been found, "the bills still represented non-existent or previously completed transactions, and [the bank] would have still suffered losses identical to those they now face."⁷⁸ The court correctly looked to the "direct" cause of the loss in determining that coverage did not exist.⁷⁹

Another important consideration in applying the correct causation requirement is the notion that a trail of occurrences or prior bad acts is insufficient to establish causation, especially where third parties are involved. For example, in *Lynch Properties, Inc. v. Potomac Insurance Co.*,⁸⁰ the insured real estate investment company sought recovery under the blanket employee dishonesty portion of its crime coverage policy when Mrs. Lynch, the company president's eighty-seven-year-old mother, sustained losses to her private accounts at the hands of an embezzling employee. The company transferred its own funds to replace the loss to Mrs. Lynch's accounts and then sought indemnity under the policy.⁸¹

Employing principles of contract interpretation, the court looked to the language of the policy to ascertain "the true intent of the parties,"⁸² finding that "[i]nclusion of the words 'resulting directly from' indicates an intent to limit the coverage available."⁸³ The court thus concluded as follows:

The "directly from" language ... allows coverage only for losses that are the immediate ... effect of employee dishonesty. Since the direct result of [the] embezzlement was a loss to Ms. Lynch's personal funds, and the indirect result was Lynch's replacement of those lost funds, ... Lynch cannot recover under the policy.⁸⁴

In claims involving the giving of security as collateral for loans, investments, or other financial transactions, even though a covered act may be involved in the loss, it is possible that outside or market forces may be to blame for the actual loss. In such a case,

⁷⁶ *Id.* at 84

⁷⁷ *Id.* at 91.

⁷⁸ *Id.*

⁷⁹ See also *California Korea Bank v. Virginia Sur. Co.*, Nos. 98-56778, 98-56806, 2000 WL 713798 (9th Cir. Jun. 1, 2000); *Liberty Nat'l Bank v. Aetna Life & Cas. Co.*, 568 F. Supp. 860 (D.N.J. 1983); *Continental Bank, N.A. v. Aetna Cas. & Sur. Co.*, 626 N.Y.S.2d 385 (App. Div. 1995).

⁸⁰ 962 F. Supp. 956 (N.D. Tex. 1996), *aff'd*, 140 F.3d 622 (5th Cir. 1998).

⁸¹ 962 F. Supp. at 959.

⁸² *Id.* at 960.

⁸³ *Id.* at 962.

⁸⁴ *Id.* at 961.

coverage should not be triggered because the direct cause of the loss is not the covered act.⁸⁵

It is virtually impossible to consider this issue without discussing the seminal line of cases involving First National Bank and Loretta Lustig.⁸⁶ In one of these decisions, *First National Bank v. Lustig*,⁸⁷ the insurer raised an affirmative defense to the bank's claim for coverage for loan losses, asserting that the losses to the insured bank were caused by a decline in the real estate market, not by the dishonesty of its loan officer. This defense came to be known as the "oil-patch defense." The lower court struck this defense, and the Fifth Circuit agreed, mistakenly applying a "but-for" causation standard. The court held that a covered loss occurs "where the bank can demonstrate that it would not have made the loan in the absence of the fraud."⁸⁸ In disagreeing with the insurer's position, the court expressed dismay at the notion that the insurer "would have [the court] read the requirement that the loss be directly caused by the dishonest or fraudulent act narrowly."⁸⁹

This decision not only applies the incorrect "but for" standard, but also it impermissibly allows coverage even when the loss is caused by intervening events. The court stated dismissively: "There will always be some intervening cause for the failure of these loans to be repaid; otherwise the bank would suffer no loss."⁹⁰ As at least one commentator has noted, the court's ruling is contrary to the fundamental premise of the allocation of risks inherent in the Financial Institution Bond, as it ignores the fact that the bank, not the insurer, "must bear the commercial risks associated with retaining ... collateral in hopes of improving economic conditions."⁹¹

The proper approach to considering the effect of market forces is demonstrated in *Leucadia, Inc. v. Reliance Insurance Co.*⁹² In that case, an investment company employee was alleged to have made fraudulent loan transactions to three separate clients.⁹³ The court found that, regardless of the employee's improper actions, the company's losses were due in considerable part to the depressed conditions of the real estate market.⁹⁴ The court also found that the company's own "internal disorganization," "mismanagement," and "failure properly to supervise its employees" contributed to the

⁸⁵ Bradford R. Carver, *Loss and Causation*, in *HANDLING FIDELITY BOND CLAIMS* 333 (Michael Keeley & Timothy M. Sukel eds., 1999).

⁸⁶ See William T. Bogaert & Andrew F. Caplan, *Computing the Amount of Compensable Loss Under the Financial Institution Bond*, 33 *TORT & INS. L.J.* 807, 825-27 (1998) (hereinafter "Bogaert II").

⁸⁷ *First Nat'l Bank v. Lustig*, 961 F.2d 1162, 1167 (5th Cir. 1992).

⁸⁸ *Id.*

⁸⁹ *Id.*

⁹⁰ *Id.*

⁹¹ Bogaert II, *supra* note 86, at 827.

⁹² 864 F.2d 964 (2d Cir. 1988).

⁹³ *Id.* at 965.

⁹⁴ *Id.* at 972.

loss.⁹⁵ Thus, the loss was not caused directly by the employee's actions, and coverage was properly denied.⁹⁶

One final causation issue requiring mention arises under those Insuring Agreements that require proof of actual and justifiable reliance by the insured on certain types of wrongful, covered acts or instruments. An insured that claims losses resulting from fraudulent conduct also faces the additional causation requirement inherent in any fraud claim, that of showing its damages were caused⁹⁷ by their justifiable and actual reliance⁹⁸ on the allegedly fraudulent conduct.⁹⁹ Similarly, proof of reliance is specifically required as an element of recovery under Insuring Agreements (D) and (E), which provide that the financial institution demonstrate that it actually relied on the forged or counterfeit documents involved in the claim.¹⁰⁰ For example, in *First Union Corp. v. United States Fidelity & Guaranty Co.*,¹⁰¹ the court held for the insurer in a case where the insured bank sought to recover losses incurred as a result of a fraudulent scheme in which it had issued loans in connection with forged incumbency certificates.¹⁰² The court interpreted the reliance language of the Bond, which stated that the insured must extend credit "on the faith of" the documents at issue in order to trigger coverage.¹⁰³ An officer of the bank testified in a deposition that the bank had approved the loans prior to receiving the incumbency certificates.¹⁰⁴ Thus, according to the court, the bank did not actually rely on the certificates in issuing the loans, and coverage was not warranted.¹⁰⁵

V. Analysis Of Direct Causation By Specific Insuring Agreement

A. INSURING AGREEMENT (A)—FIDELITY/EMPLOYEE DISHONESTY

Insuring Agreement (A) of the Financial Institution Bond provides coverage for losses resulting directly from dishonest or fraudulent acts, as those terms are more fully

⁹⁵ *Id.*

⁹⁶ Although this case was decided on the basis of "manifest intent," the implications regarding causation are clear.

⁹⁷ See RESTATEMENT (SECOND) OF TORTS § 548A (1977) (fraudulent misrepresentation is the legal cause of pecuniary loss resulting from action or inaction in reliance upon it, if, but only if, the loss might reasonably be expected to result from such reliance).

⁹⁸ See RESTATEMENT (SECOND) OF TORTS § 534 (1977) (recipient of a fraudulent misrepresentation can recover for loss if, but only if, he relies on the misrepresentation and his reliance is justifiable).

⁹⁹ See, e.g., *Fidelity Sav. & Loan Ass'n v. Aetna Life & Cas. Corp.*, 440 F. Supp. 862, 866 (N.D. Cal. 1977) (insured making fraud claim must satisfy each element of common law fraud, including justifiable reliance).

¹⁰⁰ Insuring Agreement (D) provides coverage, inter alia, for loss resulting directly from the insured having given "value on the faith of" certain forged documents. Insuring Agreement (E) provides coverage, inter alia, for loss resulting directly from the insured having actual physical possession of and relying in good faith on certain counterfeit items. See also Carver, *supra* note 85, at 352.

¹⁰¹ 730 A.2d 278 (Md. Ct. Spec. App. 1999).

¹⁰² *Id.* at 284.

¹⁰³ *Id.* at 283.

¹⁰⁴ *Id.* at 284.

¹⁰⁵ *Id.* See also *Republic Nat'l Bank v. Fidelity & Dep. Co.*, 894 F.2d 1255 (11th Cir. 1990); *United States Nat'l Bank v. Reliance Ins. Co.*, 348 Pa. Super. 30 (1985).

“defined” by the Bond, committed by an employee.¹⁰⁶ Insuring Agreement (A) has given rise to a significant number of decisions addressing the issue of causation. Most of these cases concern loan losses or losses arising out of liabilities to third parties, probably because in both types of claims the question of what really caused the insured’s losses is not as easily answered as in the case of classic employee embezzlement.

1. Loan Losses

Courts have found coverage in numerous situations related to loan losses, despite the insurers’ arguments that the alleged dishonesty of the insureds’ employees did not directly cause the insureds’ losses.

For example, in *Federal Deposit Insurance Corp. v. National Union Fire Insurance Co.*,¹⁰⁷ the FDIC sought recovery from a failed bank’s fidelity carrier for losses on loans occasioned by the failure of the bank’s trustee to disclose theft by a construction manager on the project for which the loans were extended.¹⁰⁸ Based on the uncontradicted affidavits of the bank’s other trustees that they would not have approved the loans had they known the truth about the dishonest construction manager, the court found, as a matter of law, that this nondisclosure directly caused the bank’s loss, despite the insurer’s argument that it should be allowed additional discovery to show that the loss also might have been caused by the trustee’s mismanagement or by the downturn of the real estate market.¹⁰⁹ In so ruling, the court adopted the “but for” reasoning of the Fifth Circuit in *Lustig*,¹¹⁰ discussed in Section IV, that “[a] loss is directly caused by the dishonest or fraudulent act within the meaning of the Bond where the bank can demonstrate that it would not have made the loan in the absence of the fraud.”¹¹¹

The Third Circuit also erred in *Resolution Trust Corp. v. Fidelity and Deposit Co.*¹¹² by applying a proximate cause test to determine whether to find coverage for losses resulting when the employee of a mortgage warehouse lending operation concealed the problematic status of a credit line, inducing the approval of future loans.¹¹³ The court noted that no New Jersey court had construed the “resulting directly from” language of the bond and, after analyzing New Jersey liability insurance law, determined that a New Jersey court would probably equate “direct result” with “proximate cause,” thereby finding coverage for the loss.¹¹⁴

¹⁰⁶ Financial Institution Bond, Insuring Agreement (A). Similarly, Insuring Agreement (A) of the Commercial Crime Policy insures loss resulting directly from theft committed by an employee.

¹⁰⁷ 205 F.3d 66 (2d Cir. 2000).

¹⁰⁸ *Id.* at 69.

¹⁰⁹ *Id.* at 76-77.

¹¹⁰ 961 F.2d 1162 (5th Cir. 1992).

¹¹¹ *Nat’l Union*, 205 F.3d at 76 (citing *First Nat’l Bank v. Lustig*, 961 F.2d 1162, 1167 (5th Cir. 1992)).

¹¹² 205 F.3d 615 (3d Cir. 2000).

¹¹³ *Id.* at 655-56.

¹¹⁴ *Id.* The court also was persuaded of the logic of its own prior analysis of this same policy language in *Jefferson Bank v. Progressive Cas. Ins. Co.*, 965 F.2d 1274 (3d Cir. 1992), discussed *infra*, Section V.D.

It is important to note that it is possible that the Third Circuit might have reached a different result in *Resolution Trust Corp.* if it had the benefit of the 2003 New Jersey appellate court decision in *Auto Lenders Acceptance Corp. v. Gentilini Ford, Inc.*,¹¹⁵ discussed in Section V.A.2, rejecting the proximate cause standard of causation based on the plain language of the commercial crime policy covering “direct loss ... resulting from ...”¹¹⁶

2. Liability to Third Parties—Cases Finding No Coverage

It is often observed that fidelity insuring agreements provide first-party indemnity coverage rather than liability insurance for claims against the insured by third parties.¹¹⁷ Consequently, a majority of the courts that have considered the issue appear to agree with insurers that the “resulting directly from” causation requirement excludes coverage for the insured’s liability to third parties for the dishonesty or fraud of the insured’s employees.¹¹⁸

For example, in *Aetna Casualty & Surety Co. v. Kidder, Peabody & Co.*,¹¹⁹ the primary and excess insurers sought a declaratory judgment that they were not obligated to provide coverage to a securities brokerage firm for significant losses resulting from the settlement of a series of class-action lawsuits against the firm involving allegations that its employee was involved in multiple insider-trading schemes.¹²⁰ In denying coverage, the court agreed with the insurers that the losses incurred by the firm as a result of the settlement payments were “not the direct result of the employee’s dishonest conduct ...”¹²¹ The court ruled that the settlements constituted indirect and consequential losses to the firm, which “would not constitute a covered loss” because of the exclusion for “damages of any type for which the insured is legally liable.”¹²² The court succinctly and accurately characterized the error in the insured’s causation argument:

The logical extension of Kidder’s argument, that settlement with a third-party under the factual circumstances of this case constitutes a direct loss to the insureds, would create the potential for almost any loss, not initially

¹¹⁵ 816 A.2d 1068 (N.J. Super. Ct. App. Div. 2003).

¹¹⁶ *Id.* at 1074.

¹¹⁷ *See, e.g.,* *Auto Lenders Acceptance Corp. v. Gentilini Ford, Inc.*, 816 A.2d 1068 (N.J. Super. Ct. App. Div. 2003).

¹¹⁸ In addition to the cases discussed *infra*, see *City of Burlington v. Western Sur. Co.*, 599 N.W.2d 469 (Iowa 1999) (finding no direct loss when insured city chose to replace locks on school buildings after master key disappeared in order to avoid potential third-party liability claim by school district); *Omaha Bank for Coop. v. Aetna Cas. & Sur. Co.*, 301 N.W.2d 564 (Neb. 1981) (holding that banker’s blanket bond does not insure against consequences of insured’s own torts). *See also* *Kami Kountry Broad. Co. v. United States Fid. & Guar. Co.*, 208 N.W.2d 254 (Neb. 1973) (finding indirect loss where insured bank was not legally liable for acts of its dishonest employee but nonetheless voluntarily chose to reimburse its customer).

¹¹⁹ 676 N.Y.S.2d 559 (App. Div. 1998).

¹²⁰ *Id.* at 560-62.

¹²¹ *Id.* at 564.

¹²² *Id.* at 563-64. This same exclusion for liability to third parties is found in Exclusion 2(t) of the Financial Institution Bond and D.1.d.(2) of the Commercial Crime Policy.

direct to the insureds, to become a direct loss, a subterfuge that would render the exclusion in this case clearly meaningless.¹²³

Similarly, in *Fireman's Fund Insurance Co. v. Special Olympics International, Inc.*,¹²⁴ a Special Olympics employee devised an unauthorized fundraising scheme and diverted the donations to his personal use. Upon discovering the scheme, Special Olympics sought to recover under two crime insurance policies covering "loss of, and loss from damage to, Covered Property resulting directly from the Covered Cause of Loss."¹²⁵ Construing the causation requirement, the court reiterated that "direct loss" meant the actual depletion of the insured's funds caused by the employee's dishonest acts. The court characterized "the crucial issue [as] whether the [stolen] funds resulted in a diminution of [Special Olympics] assets" and concluded that "[t]he undisputed facts establish they were not. As the funds were unknown to [Special Olympics], they were not included in [their] assets [and] the theft was of the putative donors' money," not Special Olympics' money.¹²⁶ The court also declined to find coverage for the potential liability to those whom the employee defrauded, as such loss would be only the indirect result of the employee's dishonesty.¹²⁷

A New Jersey state appellate court reached a similar conclusion in *Auto Lenders Acceptance Corp. v. Gentilini Ford, Inc.*¹²⁸ There, the insured auto dealer's salesperson submitted fraudulent loan applications to the lender to induce loans to high-risk customers.¹²⁹ The lender sued the dealer, who settled with the lender for \$215,000, whereupon the dealer sought indemnity under its commercial crime policy that covered "direct loss ... resulting from dishonest acts committed by any [employees]."¹³⁰ The lower court applied a proximate cause analysis, "the so-called Appelman's rule," discussed in Section III, and, finding "an unbroken sequence" of events all leading to a recoverable loss," held that the policy covered the loss.¹³¹ The New Jersey appellate court rejected the proximate cause analysis based on the plain language of the policy.¹³² "The policy involved here provides coverage to employers for losses sustained as a direct result of the illegal acts of employees, without any intervening event."¹³³ In reaching its ruling, the court quoted and adopted the reasoning of the Fifth Circuit in *Lynch Properties, Inc. v. Potomac Insurance Co.*: "Although employee dishonesty policies may cover the loss of third-party property in the possession of the insured, these policies do not serve as liability insurance to protect employers against tortious acts committed against third-parties by their employees."¹³⁴

¹²³ *Id.* at 564.

¹²⁴ 249 F. Supp. 2d 19 (D. Mass. 2003).

¹²⁵ *Id.* at 24.

¹²⁶ *Id.* at 27.

¹²⁷ *Id.* at 28.

¹²⁸ 816 A.2d 1068 (N.J. Super. Ct. App. Div. 2003).

¹²⁹ *Id.* at 1069-70.

¹³⁰ *Id.* at 1070.

¹³¹ *Id.* at 1071.

¹³² *Id.* at 1074.

¹³³ *Id.* at 1073.

¹³⁴ *Id.* at 1072-73.

In *Continental Bank v. Aetna Casualty & Surety Co.*,¹³⁵ the insured brokerage firm sought recovery under fidelity bonds after suffering losses from a scheme created by two of its brokers. Attempting to corner the market in Chase Medical stock, the brokers succeeded in artificially raising the price of the stock by making unauthorized cross trades in customer accounts.¹³⁶ Eventually, the American Stock Exchange noticed the scheme and halted trading in Chase Medical stock, leaving the brokerage firm holding a large number of unpaid shares.¹³⁷ The customers refused to pay for the unauthorized trades, forcing the clearing broker to purchase the shares.¹³⁸

Again, the bond covered “[l]oss resulting directly from dishonest or fraudulent acts committed by an Employee....”¹³⁹ In denying coverage, the court stated that “[t]he fact that the insured may be liable to a third party for a loss of money resulting from employee dishonesty does not transform a policy covering the insured against a direct loss into one indemnifying against liability....”¹⁴⁰ The court thus concluded that the bond did not cover the loss because trading in customer accounts did not amount to a direct loss to the brokerage firm.¹⁴¹

The court in *Finkel v. St. Paul Fire & Marine Insurance Co.*¹⁴² reached a similar conclusion. There, a trustee for KPM, a payroll administration company, sought indemnification on behalf of the company’s customers, who sustained tax liabilities due to an employee’s misappropriation of funds. KPM provided payroll services to its customers; as part of those services it collected payroll tax trust funds from its customers and (purportedly) paid the funds to the IRS and other tax authorities. KPM’s customers sustained millions of dollars in tax liabilities when the KPM president misappropriated the tax trust funds to pay personal expenses and gambling debts.¹⁴³

KPM’s blanket employee dishonesty protection rider provided that the insurance company would “pay for loss or damage to, money, securities and other property that results directly from employee dishonesty.”¹⁴⁴ The court applied principles of contract interpretation to determine the intent of the parties¹⁴⁵ and determined that KPM’s potential third-party liability was not a direct loss under the policy.¹⁴⁶

Similarly, in *Vons Companies, Inc. v. Federal Insurance Co.*,¹⁴⁷ the insured sought recovery under a commercial crime policy for a \$10 million payment it made to settle its vicarious liability for the fraudulent conduct of its employee. The fraudulent

¹³⁵ 626 N.Y.S.2d 385 (App. Div. 1995).

¹³⁶ *Id.* at 386-87.

¹³⁷ *Id.*

¹³⁸ *Id.* at 387-88.

¹³⁹ *Id.* at 388.

¹⁴⁰ *Id.* at 389.

¹⁴¹ *Id.* at 388.

¹⁴² No. 3:00CV1194(AHN), 2002 WL 1359672 (D. Conn. Jun. 6, 2002).

¹⁴³ *Id.* at *1.

¹⁴⁴ *Id.* at *2.

¹⁴⁵ *Id.* at *3-5.

¹⁴⁶ *Id.* at *8.

¹⁴⁷ 212 F.3d 489 (9th Cir. 2000).

conduct arose in connection with a practice called “diverting,” under which grocers buy and sell on a secondary market.¹⁴⁸ Diverters purchase goods on the secondary market at low prices and resell them to retailers for a profit. Vons’ employee who handled the diverting operation received payoffs from Premium Sales Company to confirm fictitious transactions. Premium obtained over \$40 million from investors as a result of the fictitious transactions confirmed by Vons’ employee.¹⁴⁹

To settle two lawsuits, Vons agreed to pay Premium’s investors \$10 million. Vons then submitted to its insurer a proof of loss stating that it had sustained “a direct loss of money ... caused by thefts and forgeries” by its employee.¹⁵⁰ The Insuring Agreement covered Vons for “direct losses” caused by theft or forgery. Construing the causation requirement, the court found that “Vons is covered only for direct losses ... caused by its employee’s dishonesty, not for vicarious liability for losses suffered by others arising from its employee’s tortious conduct.”¹⁵¹ The court thus concluded that “‘direct’ means ‘direct’ and that in the absence of a third party claims clause, Vons’s policy did not provide indemnity for vicarious liability for tortious acts of its employee.”¹⁵²

Finally, the reasoning in the *Vons* decision was instrumental to the Ninth Circuit’s subsequent decision in *United General Title Insurance Co. v. American International Group, Inc.*,¹⁵³ in which a title insurer sued to recover the amount the state required it to contribute to make up deficiencies in its escrow accounts.¹⁵⁴ Pursuant to the state insurance code, the California Department of Insurance placed the title insurer into conservatorship upon discovering the deficiencies. The title insurer paid \$828,150 to the state-created fund and then sought indemnity under a fidelity bond covering “[l]oss resulting directly from dishonest or fraudulent acts committed by a Title Agent.”¹⁵⁵

Citing *Vons*,¹⁵⁶ the court concluded that state-imposed liability was like a third-party claim, not a direct result of an employee’s dishonest acts.¹⁵⁷ The holding thus reflects an understanding that “direct” includes only those losses owing to the risks against which the agreement insures. Statutory obligations are not among those risks.¹⁵⁸

3. Liability to Third Parties—Cases Finding Coverage

While a majority of the more recent court decisions are in agreement that losses resulting from third-party liability are not covered as resulting directly from a covered risk, a few courts disagree.

¹⁴⁸ *Id.* at 490.

¹⁴⁹ *Id.*

¹⁵⁰ *Id.* at 491.

¹⁵¹ *Id.*

¹⁵² *Id.* at 492.

¹⁵³ No. 01-56770, 2002 WL 31554048 (9th Cir. Nov. 14, 2002).

¹⁵⁴ *Id.* at *1.

¹⁵⁵ *Id.*

¹⁵⁶ 212 F.3d 489, discussed *supra*.

¹⁵⁷ *United General Title*, 2002 WL 31554048, at *2.

¹⁵⁸ *Id.*

For instance, in *First American State Bank v. Continental Insurance Co.*,¹⁵⁹ the insured bank sought recovery under a banker's blanket fidelity bond for the amounts it paid to settle lawsuits brought by two of its clients. The bank's chief agricultural loan officer operated fraudulent loan schemes involving two of the bank's clients.¹⁶⁰ The clients agreed to borrow money from the bank, utilizing pre-approved credit lines, and to loan the money in turn to the loan officer. The loan officer would then execute promissory notes in favor of the clients. When the clients demanded payment and the loan officer could not pay, the clients presented their claims to the bank.¹⁶¹ After settling with its clients, the bank sought indemnification from the insurer.¹⁶²

Again, the bond provided coverage for "[l]oss resulting directly from one or more dishonest or fraudulent acts of an Employee...."¹⁶³ Misconstruing this causation requirement, the court blurred the distinction between first-party indemnity and third-party insurance, holding that "[t]he funds expended to settle [third-party] liability directly resulted from [the loan officer's] acts as a matter of law and therefore constituted covered losses under the Bond."¹⁶⁴ The court also stated, without citing any authority for the proposition, that "[f]idelity bonds were intended to cover losses derived from vicarious liability."¹⁶⁵ Thus, the court found that the Bond indemnified the loss.¹⁶⁶

4. Employee Dishonesty

After its decisions in *Resolution Trust Corp.*¹⁶⁷ and *Jefferson Bank*,¹⁶⁸ the Third Circuit continued in its determination to equate "directly resulting from" with proximate cause in *Scirex Corp. v. Federal Insurance Co.*¹⁶⁹ The insured, Scirex, was a firm that tested new drugs for pharmaceutical companies. It sought recovery under a blanket employee dishonesty policy when the results of four clinical trials were rendered worthless. The trials called for nurses to record their observations of patients for eight hours, but in many cases the nurses, though recording and submitting eight full hours of observations, actually sent the patients home much sooner.¹⁷⁰ The insurer refused to cover Scirex's loss, arguing that the loss was not "direct" but rather more closely resembled ordinary business expenses from failed ventures: "Insofar as they may be

¹⁵⁹ 897 F.2d 319 (8th Cir. 1990).

¹⁶⁰ *Id.* at 321.

¹⁶¹ *Id.*

¹⁶² *Id.* at 322.

¹⁶³ *Id.* at 325.

¹⁶⁴ *Id.* at 326.

¹⁶⁵ *Id.*

¹⁶⁶ *Id.*

¹⁶⁷ *Resolution Trust Corp. v. Fidelity & Dep. Co.*, 205 F.3d 615 (3d Cir. 2000), discussed in Section VI.A.1, *supra*.

¹⁶⁸ *Jefferson Bank v. Progressive Cas. Ins. Co.*, 965 F.2d 1274 (3d Cir. 1992), discussed in Section VI.D., *infra*.

¹⁶⁹ 313 F.3d 841 (3d Cir. 2002).

¹⁷⁰ *Id.* at 843.

called ‘losses,’ they are losses only because Scirex was unable to charge the sponsors for the studies on which they were incurred. That is an ‘indirect’ loss.”¹⁷¹

The Third Circuit disagreed and, ignoring the plain language and the purpose of the bond, reiterated the *Jefferson Bank* proximate cause standard.¹⁷² Under Pennsylvania law, as the court understood it:

[T]he ‘direct cause of a loss’ does not have to be the ‘sole cause’ or ‘immediate cause,’ but need only be a proximate or substantial cause... . Scirex’s losses were directly tied to these studies, and by rendering those studies worthless, the nurses’ behavior proximately, and therefore directly, caused Scirex’s losses.¹⁷³

B. INSURING AGREEMENT (B)—ON PREMISES

The Financial Institution Bond “On Premises” Insuring Agreement provides essentially three types of coverage. Section 2(B)(1)(a) broadly covers the loss of Property, as that term is defined in the bond, that results directly from the listed perils, as long as the Property is “lodged or deposited within offices or premises located anywhere.” Section 2(B)(1)(b) more narrowly covers loss of Property, as defined, from a second set of risks, provided the loss is the direct result of wrongful act(s) committed while the actor is present on the insured’s premises. Finally, Section 2(B)(2) provides a limited, but more traditional form of property damage coverage, insuring (a) loss of fixtures, furniture, supplies, or equipment owned by the Insured, or for which the insured is liable, while that property is in the insured’s offices; and (b) damage to the insured’s offices, provided in both cases (a) and (b) that the loss or damage is the direct result of certain listed perils, and not the result of fire.

There are several decisions interpreting the causation requirements of this insuring agreement, some of which are good examples of how the causation language in the Insuring Agreement interacts with the causation language in several of the Bond’s exclusions to preclude coverage for losses resulting from both covered and uncovered causes.¹⁷⁴ For example, in *Liberty Savings Bank, F.S.B. v. American Casualty Co.*,¹⁷⁵ an insured bank suffered losses after purchasing residential mortgage loans from a mortgage company.¹⁷⁶ The mortgage company had represented that the loans were first mortgages, but in reality all of the homes involved had existing mortgages.¹⁷⁷ Upon discovery of the existing mortgages, the insured paid a substantial amount in order to gain first mortgages on all of the properties. The insured then sought recovery from the insurer under its

¹⁷¹ *Id.* at 849.

¹⁷² *Id.*

¹⁷³ *Id.* at 849-50.

¹⁷⁴ In addition to the cases discussed in this part, see also *Empire Bank v. Fidelity & Dep. Co.*, 27 F.3d 333 (8th Cir. 1994), discussed in Section VI.C, *infra*, which concerns on premises as well as forgery claims.

¹⁷⁵ 754 F. Supp. 559 (S.D. Ohio 1990).

¹⁷⁶ *Id.* at 561.

¹⁷⁷ *Id.* at 560.

fidelity bond, claiming that the losses resulted from fraudulent acts.¹⁷⁸ The court held for the insurer, noting that the direct cause of the loss was the inability of the insured to collect on the loans it purchased, not the fraud.¹⁷⁹ Because the loss resulted “directly *or indirectly* from a default or nonpayment on an extension of credit” (emphasis added), the court found that it fell squarely within the wording and purpose of Exclusion (e), which bars coverage for losses resulting directly or indirectly from nonpayment of loans or extensions of credit.¹⁸⁰ This decision offers an excellent analysis of the part played by the “resulting directly from” language of the Bond in giving effect to the proper allocation of risk intended by the parties as to the coverage provided by this Insuring Agreement, as limited by Exclusion (e).

The court in *Mitsui Manufacturers Bank v. Federal Insurance Co.*¹⁸¹ reached a similar result in an on premises case under a pre-1980 Bond form. The insured bank accepted a series of checks for deposit into a customer’s account, only to have the issuing bank refuse payment because of forged endorsements. Because the bank had credited its customer’s account immediately and the customer had withdrawn the funds, the bank suffered “a total loss on the checks.”¹⁸² When the bank filed a claim with its fidelity insurer, seeking to recover the total amount of the loss, the insurer argued that coverage was barred by the “uncollected funds” exclusion for erroneous credits to customer accounts, noting that the language of the exclusion applied regardless of any forgery or alteration.¹⁸³ The court agreed, holding that the loss to the insured was caused by its own conduct, specifically the erroneous crediting of funds to the customer’s account. Because the forgeries were not the cause of the loss, the exclusion applied to the bank’s acts, and coverage was denied.¹⁸⁴

Although the court in *Mitsui Manufacturers Bank* reached the correct result, it used a proximate cause standard of proof, apparently at the request of the insurer, probably because the bond lacked the “directly resulting from” language of the present bond in either the insuring agreement or the relevant exclusion.¹⁸⁵ The differing bond language should be remembered in the event the *Mitsui Manufacturers Bank* decision is cited as support for using the proximate cause standard for interpreting the current Bond language, as indeed happened fourteen years later in *California Korea Bank v. Virginia Surety Co.*¹⁸⁶

¹⁷⁸ *Id.* at 561.

¹⁷⁹ *Id.* at 562.

¹⁸⁰ *Id.* at 563.

¹⁸¹ 795 F.2d 827 (9th Cir. 1986).

¹⁸² *Id.* at 828.

¹⁸³ *Id.* at 829-830.

¹⁸⁴ *Id.* at 831. The court refused to entertain the insured’s argument that the exclusion applied only to “check-kiting” schemes, insisting that it (the court) would be governed only by the plain language of the bond. *See also* United States Fid. & Guar. Co. v. Planters Bank & Trust Co., No. 492CV240SD, 1995 WL 1945556 (N.D. Miss. Feb. 10, 1995).

¹⁸⁵ *Id.* at 831.

¹⁸⁶ Nos. 98-56778, 98-56806, 2000 WL 713798 (9th Cir. Jun. 1, 2000).

In *California Korea Bank*, the insured bank suffered a loss upon settling a lawsuit filed by a customer.¹⁸⁷ Although the opinion provides few facts, it appears that the customer's husband wrongfully altered a check and withdrew funds from the customer's account. The court noted that the customer's husband "may have committed false pretenses on the premises" of the bank.¹⁸⁸ However, the court found that the husband's actions were not the direct cause of the customer's judgment and ultimate settlement against the insured bank. The loss to the customer was caused by the bank itself "as a result of the unauthorized transfer and the failure to return [the customer's] funds."¹⁸⁹ Thus, the bank could not seek reimbursement of the settlement amount from its insurer, because the bank's own breach of contract was the direct cause of the loss and not the fraudulent acts committed on the premises of the bank.¹⁹⁰

While the court in *California Korea Bank* reached the right result, it did so using the less stringent standard of causation, proximate cause, based upon its reading of California law, including *Mitsui Manufacturers Bank*, stating incorrectly that "the question whether an injury is a 'direct result' under an insurance policy is to be one of proximate causation."¹⁹¹ Because the insured was unable to meet the proximate cause standard, the court's use of a lesser standard of proof was harmless error.

As discussed in Section VI of this article, the Ninth Circuit later correctly ruled that under California law a "directly resulting" loss in a fidelity bond would *not* be equivalent to a "proximately caused" loss.¹⁹²

C. INSURING AGREEMENT (D)—FORGERY OR ALTERATION

Losses resulting directly from forgery of certain defined documents, under specific circumstances, are covered under Insuring Agreement (D) of the Financial Institution Bond and Insuring Agreement A.2 of the Commercial Crime Policy. As with the other insuring agreements, several reported decisions address the issue of what standard should be used to satisfy the direct causal link between the loss and the forgery or alteration in order to establish coverage.

*Empire Bank v. Fidelity & Deposit Co.*¹⁹³ provides an excellent example of a court's understanding of the need for proof of direct causation. In *Empire Bank*, the insured bank sought to recover under both Insuring Agreement (D) and the "On Premises" coverage of its Financial Institution Bond for losses incurred after it wrongfully cashed a series of checks with forged endorsements. The wife of an officer of the bank's corporate customer presented corporate checks payable to her household employees, which were already endorsed. The wife refused to endorse the checks herself

¹⁸⁷ *Id.* at *1.

¹⁸⁸ *Id.*

¹⁸⁹ *Id.*

¹⁹⁰ *Id.*

¹⁹¹ *Id.*

¹⁹² *United Sec. Bank v. Fidelity & Dep. Co.*, No. 96-16331, 1997 WL 632606 (9th Cir. Sept. 16, 1997).

¹⁹³ 27 F.3d 333 (8th Cir. 1994).

in the presence of bank employees, which contradicted the standard procedures employed by the bank. A bank officer repeatedly instructed bank tellers to cash the checks, despite the deviation from bank policy.¹⁹⁴ The court, upholding the decision of the federal district court,¹⁹⁵ denied recovery to the bank under its fidelity Bond.¹⁹⁶ Although the endorsements on the checks may have been forged, the loss to the bank did not result directly from the forgeries. The loss, rather, was caused by the bank's own "failure to follow...required procedures and good banking practice."¹⁹⁷ Specifically, the court held that the acts of the bank officer in failing to uphold the bank's policies were the direct cause of the loss.¹⁹⁸

In *Georgia Bank & Trust v. Cincinnati Insurance Co.*,¹⁹⁹ the court properly looked to the underlying purpose of the forgery coverage provided by a Bond to find no causation between the forgery and the bank's loss. The insured bank in *Georgia Bank & Trust* sought recovery based on defaulted obligations arising from a series of forged documents purportedly issued by a credit union, which were later determined to contain false information. The bank premised its theory of recovery on the fact that the signatures on the credit union documents were forgeries. The court held for the insurer, noting that the loss was directly caused not by the forgeries but by "the false assurances contained in the...documents."²⁰⁰ The court clearly stated that "the insurance company is not liable when the loss is caused by the nonexistence of assets purported to be assigned by a forged instrument, as opposed to a loss caused by the lack of authenticity of the instrument."²⁰¹

In interpreting the causation requirements of the bond, the *Georgia Bank & Trust* court properly looked to the purposes behind the coverage afforded by the Bond and found that it was not intended to insure against non-existent assets purportedly assigned by forged instruments. It reasoned that the practicalities of banking properly allocate the risk of loss from non-existent assets to the bank, which can and should investigate the value of its collateral.²⁰²

*First Insurance Funding Corp. v. Federal Insurance Co.*²⁰³ is another decision that underscores the fact that the mere presence of forged documents in a bank's loss will not result in coverage, if the loss is the direct result of an excluded event. In *First Insurance Funding Corp.*, an insurance finance company sought indemnification under a Financial Institution Bond for losses arising from a series of forgeries. The insured conducted its business largely through "finders" or "intermediaries," and it was one of these intermediaries whose employees committed the fraudulent acts.²⁰⁴ However, the

¹⁹⁴ *Id.* at 334.

¹⁹⁵ *Empire Bank v. Fidelity & Dep. Co.*, 828 F. Supp. 675 (W.D. Mo. 1993).

¹⁹⁶ *Empire*, 27 F.3d at 336.

¹⁹⁷ *Id.* at 334.

¹⁹⁸ *Id.* at 336.

¹⁹⁹ 538 S.E.2d 764 (Ga. Ct. App. 2000).

²⁰⁰ *Id.* at 764.

²⁰¹ *Id.*

²⁰² *Id.* at 765-76.

²⁰³ 284 F.3d 799 (7th Cir. 2002).

²⁰⁴ *Id.* at 802.

insurer denied coverage based on an exclusion for coverage “directly or indirectly” for losses caused by agents or representatives of the insured. The insured asked the court to consider how it operated its business when interpreting this exclusion, but the court declined, stating that the terms of the exclusion were unambiguous.²⁰⁵ Further, the insured entered into the fidelity contract with full knowledge of how its own business was conducted, and the court could not construe the exclusion to apply only to those intermediaries who were “acting for the insured.”²⁰⁶ Because the intermediaries who directly caused the loss were explicitly discussed in the exclusion, the court properly granted the insurer’s motion to dismiss. Once again, the court reached the right result by looking at the allocation of risks clearly provided by the policy and finding that, under the terms of the exclusion, the insured assumed the risk of loss caused directly or indirectly by the actions of the intermediaries it chose to work with.²⁰⁷

D. INSURING AGREEMENT (E)—SECURITIES

Claims under Insuring Agreement (E) of the Financial Institution Bond often involve the issue of whether losses involving admittedly forged, counterfeit, or otherwise worthless documentary collateral for loans result directly from the covered defect in the particular documents or some other intervening or overriding cause. In most cases, the courts correctly allocate the risks as between those, such as loan losses, that banks should bear, and those directly resulting from causes that the insurer has expressly agreed to insure.²⁰⁸

For example, in *Liberty National Bank v. Aetna Life & Casualty Co.*,²⁰⁹ a bank sought recovery under Insuring Agreements (A), (D), and (E) of a pre-1980 Bankers Blanket Bond for losses connected with unpaid loans. The loans in question were secured by certificates of deposit²¹⁰ issued by a bank in the British West Indies. Once the loans went into default, the insured discovered that the CDs were worthless because the issuing bank had no assets.²¹¹ In seeking recovery under the Bond, the insured argued, among other things, that the loss was covered because the signatures on the CDs had been forged or altered.²¹² The court disagreed, holding as a matter of law that, regardless of the authenticity of the signatures, the “forgery or alteration...did not cause the [insured’s] loss.”²¹³ Rather, the loss to the insured “was caused by the implicit misrepresentation in the CDs that [the issuing bank] had assets which could be used to satisfy the obligations

²⁰⁵ *Id.* at 805.

²⁰⁶ *Id.* at 805-06.

²⁰⁷ *Id.* at 806.

²⁰⁸ In addition to those cases discussed herein, see, e.g. *Reliance Ins. Co. v. Capital Bancshares, Inc.*, 685 F. Supp. 148 (N.D. Tex. 1988), *aff’d*, 912 F.2d 756 (5th Cir. 1990) (loan loss not caused by pledged, forged stock certificates, as the certificates were worthless in themselves, aside from the fact that the signatures were forged). See also *K.W. Bankshares, Inc. v. Syndicates of Underwriters at Lloyds*, 965 F. Supp. 1047 (W.D. Tenn. 1997) (court found that the bank’s loss was not due to the fact that a document offered to induce the giving of a loan was forged, but that the statements therein were not factually true).

²⁰⁹ 568 F. Supp. 860 (D.N.J. 1983).

²¹⁰ Hereinafter CDs.

²¹¹ *Id.* at 861

²¹² *Id.* at 865.

²¹³ *Id.* at 862-63, 865.

undertaken by [the insured's customers]."²¹⁴ In reaching this conclusion, the court considered the loan exclusion and observed that the purpose of the coverage clearly provided by the Bond was not to provide credit insurance. Therefore, the bank, not the insurer, had assumed the risk of worthless collateral.²¹⁵

Similarly, coverage was denied based on a causation analysis involving the allocation of credit risks to the bank in *Federal Deposit Insurance Corp. v. Firemen's Fund Insurance Co.*²¹⁶ In this case, the FDIC sought to recover for losses resulting from a complex scheme involving worthless mortgages, by seeking coverage under a fraudulent mortgage rider to a failed bank's Bankers Blanket Bond. The rider provided coverage similar to current Insuring Agreement (E). The FDIC argued that the losses resulted because the bank was fraudulently induced to sign the mortgage documents at issue. The court disagreed, finding that the worthlessness of the mortgages themselves was the cause of the insured's loss.²¹⁷ Thus, regardless of whether the signature was fraudulently obtained, it "had no effect on the value of the assignments or the underlying mortgages."²¹⁸ The fraudulent signatures did not "cause any defect" and thus were not the cause of the loss.²¹⁹ The court properly found that no coverage existed.²²⁰

Finally, no discussion of causation and the Financial Institution Bond would be complete without reference to the frequently mentioned²²¹ decision of *Jefferson Bank v. Progressive Casualty Insurance Co.*,²²² in which the Third Circuit erroneously used a proximate cause standard to determine whether a bank had suffered a loan loss as the direct result of a forged notary signature. The insured bank lent \$600,000 to Shapiro, a real estate attorney with whom it had previous dealings.²²³ The loan was to be secured by a first mortgage on property that Shapiro owned; unfortunately, he used the same property to secure loans from six or seven other banks, and as a result, the mortgage proved worthless. Jefferson soon discovered that the mortgage had not been recorded and that the notary signature was fraudulent and had been signed by an imposter.²²⁴ Jefferson sought recovery under Clause (E) of its Banker's Blanket Bond, which insured losses "resulting directly from" forgeries.²²⁵ Recognizing that Shapiro's signature was valid as between him and the bank, the district court found no coverage²²⁶ and reasoned

²¹⁴ *Id.*

²¹⁵ *Id.* at 866.

²¹⁶ 109 F.3d 1084 (5th Cir. 1997).

²¹⁷ *Id.* at 1088. The rider did not require proof of "direct" causation. Instead, like many pre-1980 bankers blanket bonds, it provided that the loss occur "through" a covered risk.

²¹⁸ *Id.*

²¹⁹ *Id.*

²²⁰ *Id.* at 1089.

²²¹ See Haley, *supra* note 38, at 633-34.

²²² 965 F.2d 1274 (3d Cir. 1992).

²²³ *Id.* at 1275.

²²⁴ *Id.* at 1276.

²²⁵ *Id.* at 1278.

²²⁶ *Jefferson Bank v. Progressive Cas. Ins. Co.*, No. 90-584, 1990 WL 180585 (E.D. Penn. Nov. 19, 1990).

that the loss was the direct result, not of the forgery, but of the bank having lent so much money with the building as security that the mortgage was worthless.²²⁷

The Third Circuit reversed, looking to general Pennsylvania tort law to interpret the causation requirement. Acknowledging that “the phrase ‘resulting directly from’ in the policy does suggest a stricter standard of causation²²⁸ than mere ‘proximate cause,’” the court held nevertheless that “conventional proximate cause is indeed the correct standard....”²²⁹ The court stated that “[u]nder Pennsylvania tort law, a cause is proximate if it is merely a ‘substantial cause’ of the harm.”²³⁰ The court refused to agree with the insurer that the parties had indeed contracted for an “immediate cause standard not recognized by Pennsylvania law,” because it believed that such a standard of causation would be so difficult and confusing to apply that the parties could not possibly have intended to contract for it.²³¹ Instead, the court concluded that “resulting directly from” meant “proximately caused by.”²³²

The court thus reversed the summary judgment in favor of the insurer and sent the case back for trial on the issue of whether the forgery was a significant enough factor in causing the loss. In so ruling, the court distinguished the cases cited by the insurer, such as *Liberty National Bank v. Aetna Life & Casualty Co.*,²³³ discussed in Section V.D, based on an analysis of when the insureds actually sustained losses.²³⁴ The *Jefferson Bank* court found it significant that, in cases such as *Liberty National Bank*, the forged collateral was always worthless, but the mortgage for Jefferson’s loan originally had value at the time the bank funded the loan; the mortgage only lost value later, when it was not recorded and other mortgages took priority.²³⁵

VI. Conclusion

Regardless of the ultimate decisions as to coverage in *Jefferson Bank*,²³⁶ and its subsequent Third Circuit progeny,²³⁷ the difficulty presented by the proximate cause or substantial factor test for causation used in these decisions is the court’s admitted refusal to enforce the bonds as written, substituting its opinion as to the reasonableness of the

²²⁷ *Jefferson*, 965 F.2d at 1280.

²²⁸ The court allowed that “[a]rguably, the words ‘resulting directly from’ suggest a requirement beyond that the cause be substantial, for the words imply that the loss must flow ‘immediately,’ either in time or space, from the forged signature.” *Id.* at 1281.

²²⁹ 965 F.2d at 1281.

²³⁰ *Id.*

²³¹ *Id.* at 1282.

²³² *Id.* at 1281.

²³³ 568 F. Supp. 860 (D.N.J. 1983).

²³⁴ *Jefferson*, 965 F.2d at 1284 n.16.

²³⁵ *Id.*

²³⁶ The Third Circuit in *Jefferson Bank* did not make a finding as to causation; it only reversed a summary judgment in favor of the insurer, arguing that there was an issue of fact on this point. The dissenting judge, however, would have confirmed the trial court’s ruling in favor of the insurer as a matter of law. *Id.* at 1286-87.

²³⁷ See *Scirex Corp. v. Federal Ins. Co.*, 313 F.3d 841 (3d Cir. 2002); *Resolution Trust Corp. v. Fidelity & Dep. Co.*, 205 F.3d 615 (3d Cir. 2000).

language used for that of the parties'. It is, therefore, appropriate to end this article with the analysis of the *Jefferson Bank* case by the Ninth Circuit in *United Security Bank v. Fidelity & Deposit Co.*²³⁸ In this unreported decision, the Ninth Circuit affirmed a summary judgment in favor of the insurer on a fidelity bond that "only insured 'loss resulting directly from' employee dishonesty and excluded all damages not 'resulting directly from' acts covered by the bond."²³⁹ The insured argued that it was entitled to coverage for expenses it incurred after its employees violated an IRS levy because these losses were "proximately caused" by employee dishonesty: "USB argues that 'loss resulting directly from' should be construed to mean 'loss proximately caused by.'"²⁴⁰ The court rejected the insured's argument and its reliance on the *Jefferson Bank* decision, stating unequivocally and simply: "We agree with the many cases which reason that 'direct' means 'direct.'"²⁴¹ The court further stated as follows:

Considering the plain meaning of "direct loss" ... we conclude that "direct loss" is much narrower than proximately caused loss. Thus, the bond issued by Fidelity did not cover all proximately caused loss, but covered only the direct loss from USB's criminal acts All of the other losses involved the presence of an intervening factor [A]nd were not covered by the bond.²⁴²

²³⁸ No. 96-16331, 1997 WL 632606 (9th Cir. Sept. 16, 1997).

²³⁹ *Id.* at *1.

²⁴⁰ *Id.*

²⁴¹ *Id.*

²⁴² *Id.*