The Fidelity Law Journal

published by

The Fidelity Law Association

Volume XIX, November 2013

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Cite as XIX Fid. L.J. ___ (2013)

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COMMON AGREEMENTS THAT ARISE IN HANDLING FIDELITY CLAIMS

Kevin P. Polansky

I. INTRODUCTION

An unfortunate reality is that employee dishonesty has affected, or will affect, almost every business and organization across the globe. After discovering a dishonest act, and any attendant loss, and notifying the fidelity insurer, the business then must decide whether to undertake the task of substantiating that loss—often times, a difficult decision to make. Before deciding to submit a proof of loss, the business's management likely will consider several of the following issues: (a) what resources will be required to investigate the loss?; (b) how much will the investigation cost?; (c) what are the limits for potentially available coverage and the likelihood that the loss will reach and exceed the limits?; (d) is claims expense coverage available to defray the cost of substantiating the loss?; (e) are there any potential tort ramifications stemming from the investigation (that is, might the business later be sued by its principal for defamation or libel)?; (f) are there any confidential documents or materials involved in the investigation?; (g) how may the loss affect subsequent coverage renewals?; and (h) are there any possible subrogation claims?[1] Determining the answers to these questions, and others, may take weeks, if not months. In these situations, the insured and the insurer may decide to enter into one or more common agreements that arise during the fidelity claims investigation or assessment process.

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[1] *See, e.g.*, John C. Eichman, *Submission Of The Insured's Claim*, *in* HANDLING FIDELITY BOND CLAIMS, 37, 45–47 (M. Keeley & S. Duffy eds., 2d ed. 2005) (discussing issues to be considered by the insured before a notice of loss is provided to its insurer).

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This article will review the practical considerations of entering into three common agreements used during the claims handling process, including extensions of time to file proofs of loss, tolling agreements and confidentiality agreements. The author examines the potential benefits and drawbacks of entering into each of the aforementioned agreements and provides a guide as to what provisions parties should consider and use in each of these arrangements.

II.
EXTENSIONS OF TIME

Commercial crime policies and financial institution bonds are usually standard forms that require an insured to provide the insurer with notice of a potential loss as soon as possible after discovery. An example of that requirement found in a commercial crime policy states:

> Duties In The Event Of Loss
>
> After you "discover" a loss or a situation that may result in loss of or damage to "money," "securities," or "other property," you must:
>
> (1) Notify us as soon as possible. If you have reason to believe that any loss (except for loss covered under Insuring Agreement A.1. or A.2.) involves a violation of law, you must also notify the local law enforcement authorities.[2]

Likewise, a standard financial institution bond may provide:

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[2] Commercial Crime Policy (Discovery Form) CR 00 22 05 06 (ISO Properties, Inc. 2005) (available from Insurance Services Office, Inc.), *reprinted in* ANNOTATED COMMERCIAL CRIME POLICY 635 (Cole S. Kain & Lana M. Glovach eds., 2d ed. 2006) [hereinafter Commercial Crime Policy].

Notice/Proof—Legal Proceedings Against Underwriter

Section 5.
(a) At the earliest practicable moment, not to exceed 30 days, after discovery of loss, the Insured shall give the Underwriter notice thereof."[3]

The notice of loss must be provided to the insurer within the time provided by the policy.[4] The contents of the notice may vary from a one page Accord Notice of Loss form to a more detailed letter with attachments. However, the insured should provide enough information to allow the insurer to identify the bond or policy at issue, the basis for the claim, when the insured discovered the act giving rise to the claim and a person at the insured's office who the claim handler can contact for additional information.[5] The notice should set forth enough information to allow the insurer to assess the potential severity and likelihood of loss and any efforts that are needed to protect its subrogation rights.[6]

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[3] Financial Institution Bond, Standard Form No. 24 (revised Jan. 1986), *reprinted in* FINANCIAL INSTITUTION BONDS (Duncan L. Clore ed., 3d ed. 2008) [hereinafter "Financial Institution Bond"].

[4] *See* Chandler Trailer Co. v. Lawyer's Sur. Corp., 535 F. Supp. 204, 205 (E.D. Ark. 1982) (dismissing fidelity claim for insured's failure to "give notice as soon as practicable to defendants." Insured provided its notice of loss over one year after discovering the loss). Providing timely notice to the insurer is extremely important in order to provide the insurer with an opportunity to investigate the fraud; *see also* Bob O'Brien & Jeffrey S. Price, *Fidelity Law Update*, at 4 (unpublished paper presented at the Sixteenth Annual Southern Surety and Fidelity Claims Conference, April 21-22, 2005) (identifying cases that held that "[b]ecause the Insured failed to give timely notice, the Insurer was deprived of the opportunity to investigate the fraud or utilize its contacts within law enforcement to locate the assets before they were fully dissipated.")

[5] *See* Donald L. Mrozek, David A. Benfield, John M. Christenson & Elizabeth F. Staruck, *Common Issues Which Arise In the Investigation of the Fidelity Bond Claim*, at 2 (unpublished paper presented at the 2013 Midwinter Meeting of the American Bar Association, Fidelity & Surety Law Committee, Jan. 24, 2013) ("At a minimum, the initial notice should contain sufficient factual information to describe the loss and when the insured discovered it.").

[6] *See* Mark E. Wilson, *How to Prepare and Present a Fidelity Claim: Advice for the Insured*, THE BRIEF, Spring 1999, at 54, 56–57.

Submitting a notice of loss begins the claim process for the insurer. However, the insured's initial suspicion of the dishonesty is just the first step in its investigation. In many cases, the insured then must undertake the effort and expense of investigating the facts giving rise to the claim and evaluate whether the claim falls within the parameters of the insured's coverage. These steps provide the foundation for substantiating its claim and submitting sworn proof of loss to its insurer. Each crime policy and fidelity bond provides a certain period of time to submit proof of loss. Proof of loss requirements for a standard Commercial Crime Policy and Financial Institution Bond are as follows:

> Commercial Crime Policy[7]
>
> (2) Give us a detailed, sworn proof of loss within 120 days.
>
> Financial Institution Bond[8]
>
> (b) Within 6 months after such discovery, the Insured shall furnish to the Underwriter proof of loss, duly sworn to, with full particulars.

It is imperative that the insured submit its sworn proof of loss within the applicable period, because the failure to do so may bar the insured's claim. Many courts have held that timely submission of a proof of loss is a condition to enforcing the insurer's liability or filing suit on an insured's claim.[9]

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[7] *See* Commercial Crime Policy, *supra* note 2, § E.1.g.(2).

[8] *See* Financial Institution Bond, *supra* note 3, § 5(b).

[9] *See* Richard S. Mills & Frederick M. Zauderer, *At the Apex of the Arc of the Pendulum: Does* FDIC v. INA *Spell the Beginning of the End of the Notice Prejudice Rule in Fidelity Cases?*, IV FID. L.J. 127, 132, app. A (1998) (identifying the jurisdictions which still enforce notice provisions of insurance contracts). *But see* Md. Cas. Co. v. Clements, 487 P.2d 437, 442–43 (Ariz. Ct. App. 1971) (failure to submit proof of loss with sworn facts is not a defense to liability absent prejudice to insurer, despite express language in the policy); Greg Veal & Gerald N. Carozza, Jr., *Trust But Verify: Proof of Loss*, at 6 (unpublished paper presented at the 2012 Midwinter Meeting of the American Bar Association, Fidelity & Surety Law Committee, Jan. 26, 2012) (discussing

Sometimes the insured cannot complete its claim investigation in advance of the deadline for submitting a proof of loss. This inability may result from an incomplete investigation, documentation resting in the hands of third parties (including customers, government officials or law enforcement agencies), pending litigation by or against the insured in connection with the loss, pending criminal prosecution, and the claim's own complexity.[10] In addition, the insured may have concerns about "making specific allegations of fraud against an employee until further information is collected . . . ."[11] In situations where the insured anticipates that it cannot comply with its obligations to submit a sworn proof of loss within the time specified in the applicable bond or policy, the insured should request an extension from the insurer. The insured should request the extension in writing and should explain the basis for the request.[12] However, there is no requirement that the insurer grant the extension request.

The insurer should consider several questions prior to granting the request for an extension:

- Has the notice period expired for submitting a proof of loss?;
- When does the notice period expire and is the discovery of the loss date at issue?;
- Will the extension prejudice the insurer in investigating the claim or in its subrogation attempts?;[13]

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recent case law applying the "no harm, no foul" rules with respect to fidelity bond provisions).

[10] *See* Ronald G. Mund, *The Claim Handler's Initial Analysis and Response to the Claim*, *in* HANDLING FIDELITY BOND CLAIMS, 64 (M. Keeley & S. Duffy eds., 2d ed. 2005).

[11] Jeffrey S. Price, *Claim Acceptance/Denial*, at 5 (unpublished paper presented at the 2013 Midwinter Meeting of the American Bar Association, Fidelity & Surety Law Committee, Jan. 24, 2013).

[12] Wilson, *supra* note 6, at 59.

[13] *See generally* Price, *supra* note 11, at 5 ("While it may prejudice the insurer to allow the insured to conduct an extended internal investigation, the insurer should at all times be sensitive to the insured's concern that premature

- Have relevant witnesses been identified and is there any likelihood that they may become unavailable before the extension expires?;

- Is the principal's location known and what is the criminal prosecution status?;

- Will the insured's time for filing suit expire prior to the expiration of the extension period?; and

- Is the amount of time requested reasonable given the complexity of the claim?

It is possible that at this point in the investigation, the insurer might not know the date when the actual loss was discovered. In light of that fact, the insurer should be mindful of not extending the proof of loss period to an exact date in time.[14] In other words, if the claim handler determines that an extension is reasonable and justified, it should be granted for a period of time—likely in terms of months (such as 2 months or 3 months)—beyond the date when proof of loss is otherwise due pursuant to the terms of the policy or bond. It likewise should state that the later filed proof of loss shall have the same force and effect as it would have had if the insured had filed it on the date of the requested extension. This prevents the insurer from waiving defenses if it later learns that the

allegations of fraud against an employee may result in liability on the part of the insured."); *see also* Gary M. Case, *Subrogation Rights and the Fidelity Insurer: How to Protect Them, and What to Do When They Have Been Prejudiced*, at 6 (unpublished paper presented at Eighth Annual Northeast Surety and Fidelity Claims Conference, Nov. 6-7, 1997), *available at* http://www.forcon.com/papers/nesfcc/1997/07.Case.pdf ("Analysis of potential subrogation rights and options should be one of the first steps undertaken by the insurer. A failure to do so may result in impairment in subrogation rights because of the tolling of a statute of limitations with respect to a potential target . . . .").

[14] *See* Am. Mut. Share Ins. Corp. v. CUMIS Ins. Soc'y, Inc., No. 08AP-576, 2009 WL 205373, at *1 (Ohio Ct. App. Jan. 29, 2009) (sixty-day time period for giving insurer notice of loss began to run at time credit union's directors discovered facts that would cause them to assume that credit union had suffered a loss caused by dishonest acts of employee).

insured discovered the loss much earlier or the period to file a proof of loss had already expired.[15]

If the extension is granted, it should be in writing and subject to certain conditions. The conditions should address the following:[16]

1. By agreeing to the extension of time, the insurer does not admit that the time to file has not already expired;

2. Expired claims are not revived by the extension;

3. The extension is neither an admission of any coverage nor an admission that there has been compliance with the terms and conditions of the policy; and

4. The extension does not waive, alter, amend, or change any term or provision of the policy.[17]

Further, the insurer may want to add an additional condition that the insured provide the insurer with all information that it currently has for the claim. The notice of loss generally does not require the insured to provide substantial claim information, and this added condition provides the insurer with an opportunity to review some claim information before receiving all materials relied upon to substantiate the loss. Several commentators suggest that the extension should contain similar language to the following:[18]

> The insured agrees to provide a detailed statement of all information presently available to the insured regarding the claim along with copies of all documents presently in the insured's possession relevant to the claim no later

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[15] *See* Mund, *supra* note 10, at 88.

[16] *See id.*

[17] *See* Capitol Fixture & Supply Co. v. Nat'l Fire Ins. Co. of Hartford, 279 P.2d 435, 437(Colo. 1955) (en banc) (holding that insurer did not waive full compliance with terms and conditions of policy by agreeing to delay suit beyond the contract period as expressly stated in the extension); *see also* Price, *supra* note 11, at 6 (advising insurer to reserve all rights and not waive or limit any defense under the policy).

[18] *See* Mund, *supra* note 10, at 88.

> than (insert specified date). The insured agrees that furnishing such information and documents is not the furnishing of a proof of loss in accordance with the terms of the fidelity bond.

There are certain benefits to allowing extensions. In many cases, they are given to prevent, avoid or delay litigation. An extension also will provide the insured with valuable time to investigate and potentially resolve the claim. The obvious truth to resolving the claim is that both the insured and insurer may avoid incurring unnecessary litigation costs. In addition, this cooperative spirit may prove vital to understanding the claim and determining whether coverage is available.

Extensions should be granted on a case-by-case basis. The purpose of the extension is typically to allow an insured additional time to assess and determine the legitimacy, viability and amount of its claim, and enable the insured to provide its insurer more complete information regarding the particulars of that loss. The time period for filing proofs of loss vary by bond or policy and by state. Some jurisdictions provide their own time periods for submitting proofs of loss, which may trump the bond or policy at issue.[19] It is important for practitioners to review the laws of the state where the bond or policy was issued.

III. TOLLING AGREEMENTS

A. What is a Tolling Agreement?

Almost all bonds and insurance policies contain a provision that limits the period in which the insured may bring suit against the insurer for determination of its claim. These provisions are generally enforceable unless they are trumped by state statutes that require a longer limitations period. If a contractual limitations period is unenforceable in a particular jurisdiction, the time to file suit will be governed by the applicable statute of limitations. A tolling agreement is an insurer's

[19] *See* Joel P. Williams, David D. Gilliss & Jason W. Glasgow, *Time (and Time Again?): Contractual Limitations and Waiting Periods*, FOR THE DEFENSE, Mar. 2008, at 11 (discussing limitation clauses in insurance policies and their enforceability under controlling statutes).

written agreement with the insured to suspend the running of the limitations period for a particular claim. In most cases, the agreements are mutual. For example, the insured also will agree to suspend the limitations period applicable to any claim, defense, counter-claim or cross-claim that the insurer might have.

Generally, these agreements are entered into to allow the insured additional time to assess and determine the legitimacy and viability of its claim or the amount of its damages without the necessity of filing an action. These agreements may "facilitate[] meaningful settlement discussions aimed at heading off litigation . . . ."[20] If the limitations period has not lapsed and the repose period has not expired, a tolling agreement may be prudent whenever a reasonable justification for the request exists, such as ongoing, but incomplete, investigation of the loss or pending criminal prosecutions.[21] The tolling agreement should state expressly that the tolling agreement does not revive expired claims.[22] It is important to note that tolling agreements are not always enforceable. The parties should review applicable jurisdictional law before entering into a tolling agreement.[23]

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[20] Salmon Prot. & Watershed Network v. County of Marin, 140 Cal. Rptr. 3d 290, 296 (Cal. Ct. App. Apr. 20, 2012), *review denied* (July 11, 2012).

[21] However, the insurer needs to be cognizant of not reviving lapsed claims. The insurer should toll any claims from the date of executing the tolling agreement, but not the date of discovery of the loss. *See* SPPI-Somersville, Inc. v. TRC Cos., Nos. C 04-2648 SI, 07-5824 SI, 2009 WL 2390347, at *7 (N.D. Cal. Aug. 3, 2009) (holding that expired claims had been revived by the tolling agreement which (a) did not explicitly state that expired claims would not be revived by the agreement and (b) the agreement tolled the claims from the date of discovery and not the date of the agreement's execution).

[22] *See* Porwick v. Fortis Benefits Ins. Co., No. 99 CV 10122(GBD), 2004 WL 2793186, at *7 n.4 (S.D.N.Y. Dec. 6, 2004) (holding that expired claims were not revived because of express provision in tolling agreement that stated "[c]laims, if any, that would be barred under applicable statutes of limitations as of August 25, 1997 are not intended to be revived by this Tolling Agreement.").

[23] For example, an agreement to extend the applicable limitations period may be unenforceable under Mississippi Law. In Mississippi a tolling agreement is only enforceable if: "(1) it is not prohibited by statute; (2) it contains a definite and reasonable time period; (3) it is formed after the cause of

B. What Provisions Should a Tolling Agreement Contain?

A tolling agreement can be written in any number of ways, but should contain several basic provisions. While obvious, it is important to include all names of the parties to be included in the agreement and the date the agreement is effective.[24] Further, the parties must provide a description of the claim with reasonable specificity in order to describe appropriately what claim the parties are agreeing to toll.[25]

The parties likewise should consider including several important conditions. Each party should reserve its rights in full, including any and all affirmative defenses. The parties should include a statement that the agreement may not be used or relied upon for any purpose other than the enforcement of its terms. They should include a provision that the agreement shall in no event be construed or deemed to be evidence of any admission on the part of any of the parties as to any liability, coverage, wrongdoing, or any other purpose, unless otherwise expressly stated.

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action has accrued, or in the instance of repose, after the plaintiff has notice of the cause of action; (4) it is not made at the same time as, or part of, the obligation sued upon; and (5) it is entered into before the expiration of the applicable limitations period." Townes v. Rusty Ellis Builder, Inc., 98 So. 3d 1046, 1055 (Miss. 2012).

[24] *See* Caguas Cent. Fed. Sav. Bank v. United States, 215 F.3d 1304, 1309–10 (Fed. Cir. 2000) (holding that "only parties to the tolling agreement could enforce their rights thereunder" and its purpose was not to "permit litigation of th[e] claims by third persons.").

[25] *See* Camico Mut. Ins. Co. v. Citizens Bank, 474 F.3d 989, 993 (7th Cir. 2007) (holding that the terms of the parties' tolling agreement were unambiguous and must be enforced as written). The *Camico* case provides an example for why the claims to be tolled must be specifically described. The parties in *Camico* entered into a tolling agreement that stated that "all statute of limitations *defenses and other defenses* relating to the time that claims are asserted are tolled from the Effective Date through the date of termination of this Tolling Agreement." *Id.* (emphasis added). The term "statute of limitations defenses" was not defined under the agreement. As a result, one party argued that all of the statute of limitations claims were tolled, while the other party argued it was just statute of limitations defenses that were tolled. The Court held that "only the statute of limitations defenses and other defenses were tolled." *Id.* As a result, parties must be clear in their agreement as to what claims they are agreeing to toll.

The parties should describe generally the reasons for entering into the agreement and provide the rights and defenses that each party is preserving under the agreement. For example, the parties may wish to include a provision such as:

> Each Party hereby covenants and agrees not to assert, in any litigation involving the Claim [as defined therein], including in any complaint, counterclaim, cross-claim, or third-party complaint, or other pleading, a claim based in whole or in part upon any statute of limitations, contract provision, upon laches, or upon any other failure to institute or commence litigation or other proceedings within a period, before a date, or before the happening of an event based on the passage of time from _____ [the effective date of the agreement] to _______ [the end date of the agreement] (the "Tolling Period"). However, nothing in this Tolling Agreement shall act as a waiver of or bar to the assertion of any claim or defense which was in existence as of _______ [the effective date of the agreement]. Each Party further stipulates, covenants, and agrees that the running of any statute of limitations, contract provision, laches period, or any similar or other period of time shall be suspended and shall not run during the Tolling Period.

It is important to limit the duration of the tolling agreement, because agreements without a definite deadline seem to foster delay, which may prejudice the insurer in the event the claim does not resolve. In addition, the parties should include a provision for early termination. The failure to include a time limit or early termination clause may create confusion with respect to when the agreement ends or when a party may file a claim. This issue is illustrated by the case of *E-Pass Technologies v. Moses & Singer, LLP*,[26] in which the tolling agreement entered into between the parties did not contain a forbearance requirement that prevented the insured from filing suit prior to the termination of the agreement. The *E-Pass Technologies Court* held:

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[26] No. C-09-5967 EMC, 2012 WL 1267842, at *5 (N.D. Cal. Apr. 13, 2012).

> If Defendants wanted Plaintiffs to wait until the underlying appeal was complete before filing suit, they could have so drafted the tolling agreement. They did not do so. If they wanted to provide that once Plaintiff filed a lawsuit, all bets were off and the tolling agreement was terminated, they could have so drafted such language. Again, they did not. In short, there is no discernible purpose understood by both parties which was frustrated by Plaintiff's filing of the state suit in January, 2009.[27]

A forbearance clause typically states that "the Parties covenant and agree that they will not commence any litigation against the other relating to the Claim before ________ [the termination date of the agreement]."

In addition to the foregoing issues, some other applicable provisions that should be considered for a tolling agreement include the following:

- Consequences for breach of the agreement;
- The agreement shall have a binding effect on all parties and their successors, etc.;
- Choice of law;
- Provision that the agreement contains the full and complete agreement of the Parties and may only be altered by written agreement by the Parties thereto;[28]
- The Parties executing the agreement has the authority to do so;

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[27] *Id.*

[28] Wheeler Elec., Inc. v. ABT Serv. Corp., No. 96-35359, 1997 WL 312599, at *1–2 (9th Cir. June 9, 1997) (holding that the authorization provision in the tolling agreement was enforceable and "clothed [the signer] with apparent authority" to execute it).

- The Agreement will not be construed against the drafter; and
- Each Party stipulates that the terms, extent and duration are reasonable.

A tolling agreement should be entered into on a case-by-case basis. The potential benefits of entering into it are that it encourages cooperation between the insured and insurer and facilitates early resolution of claims. In addition, formal discovery in a lawsuit can be lengthy and expensive. A tolling agreement may enable the free flow of information in an informal setting, thereby decreasing the costs of discovery and potentially avoiding litigation costs altogether.

There are several potential drawbacks of entering into a tolling agreement. The insured may believe that it has increased leverage in settling its claim or filing its suit because the insurer has agreed to suspend the limitations period. In addition, if the tolling agreement is not drafted properly, a court may determine that the insurer waived some of its defenses, including defenses relating to the discovery of the loss and/or proper notice of the claim. Generally, a properly prepared tolling agreement will encourage cooperation among the parties and help facilitate the efficient resolution of the claim.

IV.
CONFIDENTIALITY AGREEMENTS

A. What is a Confidentiality Agreement?

A confidentiality agreement is a legal contract between at least two parties that allows those parties to share confidential documents, knowledge and information with one another, while simultaneously restricting or precluding entirely third-party access to the same materials or information.[29] In the fidelity context, a confidentially agreement

[29] *See* Wikipedia, *Non-disclosure Agreement*, http://en.wikipedia.org/wiki/Non-disclosure_agreement (last visited Aug. 28, 2013); *see also* Martin Marietta Materials, Inc. v. Vulcan Materials Co., 68 A.3d 1208, 1219 (Del. 2012) ("A confidentiality agreement . . . is intended and structured to prevent a

provides the insured with the added protection of knowing that confidential materials produced to the insurer during the claims investigation will remain confidential and will not make their way into the public domain. In addition, if the insured is a financial institution, a confidentiality agreement may relieve some of the insured's concern with respect to producing customer records. Indeed, in some jurisdictions, statutes prohibit financial institutions from producing customer financial records or loan information without prior notice provided to the customer.[30]

A confidentiality agreement may describe specific types of documents or information that an insurer will need to complete its investigation or may state more generally that the insured will provide any documents needed for the claim investigation. The contents of a confidentiality agreement may vary greatly in each circumstance, but several important provisions should be considered.

B. What Should a Confidentiality Agreement Look Like?

A confidentiality agreement must identify the types of people and businesses that will disclose the information and that are entitled to receive that information. Although the agreement need not, and frequently does not, specify individuals by name, it should provide sufficient information to enable all parties to understand who may view the confidential materials. The agreement also should provide the scope of the information covered by the agreement. The parties need not identify every document; however, it is prudent to, at a minimum, identify categories or types of documents that the parties agree are subject to the confidentiality agreement. This description allows the

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contracting party from using and disclosing the other party's confidential, nonpublic information except as permitted by the agreement.").

[30] David D. Crane, *Discovery From Regulatory Agencies: Leveling the Playing Field*, at 4 (unpublished paper presented at Fourth Annual Northeast Surety and Fidelity Claims Conference, Oct. 28, 1993), *available at* http://www.forcon.com/papers/nesfcc/1993/07.%20Crane.pdf; Scott D. Baron, *The Fidelity Loss Investigation in a Regulated Industry*, THE BRIEF, Spring 1999, at 12, 18 (discussing relevant cases requiring financial institutions to protect the confidentiality of their clients' records); *see also* Eichman, *supra* note 1, at 61–62.

parties to acknowledge and be fully aware of the extent of the disclosures to be made. The parties should take steps to verify that the documents and information sought to be treated as confidential is not already in the public domain.

For example, if the insured seeks to protect trade secret information from possible disclosure to third parties, the insured should mark each document containing the information "confidential." The definition of what constitutes a "confidential" document or piece of information likely will differ in each case. For example, the definition could specify whether documents covered by the attorney-client privilege, the work product doctrine or other privileges and immunities are intended to be covered. The definition could specify whether it covers tangible materials such as written communications, as well as intangible information in the form of oral communications.

The agreement also should contain a protocol that provides guidance as to how the parties (a) will designate the information and/or documents confidential, (b) may use the documents and/or information, and (c) should maintain the information and documents so as to ensure that their confidentiality is protected.

Insureds generally desire or expect confidentiality with regard to their financial status and transactions. However, when investigating the claim, the insurer needs access to certain relevant financial information, which the insured must provide in a timely fashion. In order to accomplish these objectives efficiently, the insurer may negotiate a confidentiality agreement limiting to whom the insurer may disclose the confidential information.

It also may be important to include a provision outlining the actions that the insurer may undertake without violating the confidentiality agreement.[31] By doing so, each party is given a full

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[31] *See* Bernard A. Reinert, Aaron G. Weishaar & Jennifer M. Slominski, *Negotiating the Intersection Between the Exceptions to Sunshine Laws and the Duty to Cooperate by Insureds and Bond Principals*, at 18 (unpublished paper presented at Nineteenth Annual Northeast Surety and Fidelity Claims Conference, Sept. 18-19, 2008), *available at* http://www.

understanding as to how the disclosed information may be used in order to avoid any inadvertent breaches.

With respect to future litigation arising out of or related to the claim, the parties may want to include a provision stipulating that the parties may use the confidential documents, notices or information in any legal action arising out of the claim in accordance with the terms of the confidentiality agreement, provided that prior to using those materials publicly or filing them with a court, the party wishing to preserve the confidentiality will take steps to protect the materials through court order sealing same or by other agreed upon means. Further, the parties may wish to specify the measures necessary to preserve confidentiality when confidential materials are used as evidence during a trial.

Along these lines, it is advisable that the agreement should include a durational provision that outlines how long the agreement will remain binding on the parties and the parties' rights and remedies upon breach of the agreement.[32] For example, the provision may state that the obligations under the confidentiality agreement end when the materials are destroyed.

In addition, the agreement may provide a condition setting forth the protocol for a unilateral termination of the agreement. The protocol can include such things as requiring a reasonable attempt be made to give notice at a specific address.

The confidentiality agreement should specify the types of people and businesses with whom the parties may share information designated as confidential, including accountants, attorneys, other insurers and reinsurers, and others where required by law. The parties should consider including a procedure to follow for responding to requests from other third parties with respect to the confidential materials. Generally, the parties will agree that if a request is made by a third party for confidential information, the party receiving the request will attempt to notify the other party and provided that party with a copy of the request. After notification, the parties may want to collaborate on preparing an

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forcon.com/papers/nesfcc/2008/05.%20Reinert.pdf (describing contents of a confidentiality agreement).

[32] *See id.* at 18–19.

appropriate response that includes the assertion of all applicable privileges and immunities with respect to the confidential information, including taking any necessary judicial steps to preserve the confidentiality of the materials.

Every confidentiality agreement will differ depending upon the scope of the disclosure and the needs of the parties involved. However, there are some additional terms or provisions that the parties may wish to consider. For example, the parties may wish to include language regarding how the agreement can be modified, what law should apply to any disputes, the binding effect the agreement has on the parties and their successors, and the need of the parties to cooperate to further the purpose of the agreement.

It is important to note that the failure or decision not to enter into a confidentiality agreement, does not relieve the insured from its duty to cooperate.[33] In *Pilgrim v. State Farm Fire & Cas. Ins. Co.*[34] case, the insured argued that it did not breach the cooperation clause because the insurer failed to enter into a confidentiality agreement protecting the disclosure of certain financial records. Conversely, the insurer argued that it could not enter into the agreement because it would have precluded it from releasing information to any third party, including the police. The insurer had a statutory obligation under Washington law to report fraud to law enforcement agencies. As a result, the Court held that the insurer "reasonably refused to sign it" and the insured's refusal to provide their financial information breached the cooperation clause under the policy.[35]

C. Are There Benefits and Pitfalls of Entering into Confidentiality Agreements?

There are many benefits to entering into a confidentiality agreement. Most importantly, it fosters the free flow of information from the insured to the insurer. This exchange allows the insurer access to all information that it needs to assess the claim fully and insulates the

[33] *See* Pilgrim v. State Farm Fire & Cas. Ins. Co., 950 P.2d 479, 484 (Wash. Ct. App. 1997).
[34] *Id.*
[35] *Id.*

insured from wrongfully disclosing confidential information and client records without adequate protection. Moreover, it provides a basis to resolve a situation where the insured refuses to produce confidential materials. An often overlooked benefit is the cooperation it brings in exchanging information between the insured and the insurer. It also provides another layer of protection against disclosure to third-parties.

The benefits of entering into a confidentiality agreement often outweigh any potential pitfalls. However, these agreements are not without some risks. One notable drawback exists if the matter proceeds to litigation and the insurer needs to overcome some additional hurdles to use previously disclosed information during litigation and eventually trial. There likewise remains the risk that one of the parties unintentionally reveals the confidential information. It can be beneficial if the agreement contains a provision regarding consequences for any breaches of the agreement to address adequately the harm that may result.

D. How Far Can an Insured Go in Demanding a Confidentiality Agreement?

With the passage of the Gramm-Leach-Bliley Act (the "Act") of 1999,[36] "financial institutions"[37] must now comply with the Financial

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[36] Also known as the Financial Services Modernization Act of 1999, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified in pertinent part at 15 U.S.C. §§ 6801–6809 (2006)).

[37] *See* 15 U.S.C. § 6809(3). The Federal Trade Commission succinctly explains what entities qualify as a "financial institution":

> The definition of 'financial institution' includes many businesses that may not normally describe themselves that way. In fact, the Rule applies to all businesses, regardless of size, that are 'significantly engaged' in providing financial products or services. This includes, for example, check-cashing businesses, payday lenders, mortgage brokers, nonbank lenders, personal property or real estate appraisers, professional tax preparers, and courier services. The Safeguards Rule also applies to companies like credit reporting agencies and ATM operators that receive information about the customers of other financial institutions.

Privacy Rule and Safeguards Rule under the Act.[38] The Financial Privacy Rule requires financial institutions to provide each consumer with a privacy notice at the time the consumer relationship is established and annually thereafter.[39] The Safeguards Rule has applicability to the fidelity claim investigation process. The Safeguards Rule requires a financial institution to develop written information security plans that describe how the company is prepared, and plans to continue, to protect clients' nonpublic personal information.[40] Under the Act, a financial institution is now required to ensure security and confidentiality of many types of customer information, including customer names, addresses, phone numbers, bank and credit card numbers, income and credit histories and social security numbers.[41]

1. How to Comply

Under the Act, a company must develop a written information security plan that describes its program to protect customer information. The plan must include (a) identifying at least one employee who will manage the safeguards, (b) constructing a thorough risk analysis on each department handling the nonpublic information, (c) developing, monitoring and testing a program to secure the information and (d) changing the safeguards as needed with variants on how information is collected, stored and used.[42]

Companies must develop a plan appropriate to the size and complexity of the company, the nature and scope of its activities and the sensitivity to the customer information that it collects and stores.[43] The requirements are meant to be flexible, and a company should implement

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FED. TRADE COMM'N, FINANCIAL INSTITUTIONS AND CUSTOMER INFORMATION: COMPLYING WITH THE SAFEGUARDS RULE, http://business.ftc.gov/documents/bus54-financial-institutions-and-customer-information-complying-safeguards-rule [hereinafter "Complying with the Safeguards Rule"]; *see also* 16 C.F.R. § 313.3(k) (defining "financial institution" and providing examples of what does and does not fall within the definition).

[38] 15 U.S.C. §§ 6801–6809.

[39] *See* 15 U.S.C. § 6803; *see also* 16 C.F.R. §§ 313.4, 313.5.

[40] *See* 15 U.S.C. §§ 6801–6809.

[41] *See Complying with the Safeguards Rule, supra* note 37.

[42] *Id.*

[43] *Id.*

safeguards unique to its own circumstances.[44] The Act was constructed to force a company to take a closer look at how it manages and protects private customer data.

2. Relevance to Fidelity Claims Investigation

As a result of this stricter enforcement of confidentiality and privacy, "financial institutions" have taken a stronger stance on requesting a confidentially agreement during the claims investigation. An insured may rely on the Act as an example of the extra precautions it is required to take to protect its clients' confidential information. In addition, the insured even might request that the confidentiality agreement contain a reference to the Act in order to show compliance therewith.

V. CONCLUSION

There are many vehicles that the insured and its insurer may use to allow for the free flow of information after diligent investigation of a claim, while simultaneously protecting each parties' rights and obligations. If crafted properly and with a view toward the unique circumstances that each claim presents, agreements like those discussed throughout this paper ensure that each party has the time necessary to investigate fully and timely the efficacy of making a claim, the extent of any loss and the coverage that exists to respond to such loss. Cooperation between the insured and insurer as they navigate the increasingly common world of employee dishonesty serves both parties' interest and often obviates the need for costly litigation and business disruption to bring to a close the determination of a claim.

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[44] *Id.*