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THE INSURANCE NEWSLETTER

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Employee Dishonesty and Criminal Records

There have been a number of articles in the news lately commenting on the relatively large number of U.S. residents who have found ways to run afoul of the law in ways that left them with a criminal record; reportedly, the U.S. leads all first world countries in the percentage of population who have a criminal record. Worth remembering is that not all of these violators are guilty of serious crimes; the definition of "criminal" can include any non-traffic related offense, a broad brush indeed. Nor is a conviction even required, only an arrest that may never have led to charges being filed. And in these days of digital records, nothing is ever forgotten. Youthful indiscretions that in the past might have been handled less formally and eventually forgotten (think shoplifting, pranks that might lead to charges of vandalism, or possession of small amounts of marijuana as fairly typical youthful idiocies) now go into a person's "permanent record" (ever hear that phrase in school?) and are never forgotten, and always retrievable by a potential employer or almost anyone else with a credit card. And there are also many who might have been guilty of more serious offenses way in the past but with age and maturity have turned their lives around.

This is a problem for the affected individuals, but its also a problem for any business that might wish to employ them. There is a practical issue here, if you are one of those employers with positions to fill that require specific skills or experience; if you automatically disqualify for criminal records your pool of potential applicants may get much smaller. More broadly, employers who might have in the past been inclined to automatically disqualify for employment any applicant with a criminal record are under increasing pressure to take a more nuanced approach.

While that may be a socially desirable approach that a responsible employer might want to consider for both altruistic and practical reasons, there is a downside. We have written in the past about a severe but often overlooked risk that businesses face from employee dishonesty losses. Theft, embezzlement, illegal conversion of business funds or property and other employee crimes cost businesses millions each year (some industry sources have estimated that annual losses from employee dishonesty exceed those from fires). One can only assume that, no matter the nature of the violation or length of time passed since a criminal violation occurred, an employee with a record likely presents some level of increased risk for an employee dishonesty loss.

Of course your well thought out insurance program includes an employee dishonesty policy, but if you are relying on that to cover you if you suffer a loss from an employee with a record, better think again. Most employee dishonesty policies indicate that coverage ceases for any employee immediately upon discovery by the policyholder of a dishonest act committed by that employee. The relevant wording of the exclusion in the standard Insurance Services Office commercial crime policy form is as follows:

"Exclusion 1. b. Acts Of Employees Learned Of By You Prior To The Policy Period

Loss caused by an "employee" if the "employee" had also committed "theft" *or any other dishonest act* prior to the effective date of this insurance and you or any of your partners, "members", "managers", officers, directors or trustees, not in collusion with the "employee", learned of that "theft" *or dishonest act* prior to the Policy Period shown in the Declarations." *(italics added).*

Translated from insurance-speak, that means that if you do a criminal background check on a prospective employee, find something, and go ahead and hire them anyway, your chances of ever recovering on an employee dishonesty claim involving that employee may be impaired.

This exclusion has the potential to trip you up in other ways, too. We have encountered instances where an employee has been caught in a dishonest act, and the employer has chosen to resolve the situation without presenting an insurance claim. Theoretically these could be incidents as innocuous as stealing office supplies or padding an expense account. After a period of time, the same employee perpetrates another theft against the insured, and for this a claim is presented. If a look into the employee's personnel file revealed the prior dishonest act that had been discovered previously, coverage for that employee disappears.

The key to remember here is that the term "dishonest act" is not defined in the policy, which gives a claims adjuster wide latitude in interpretation of the exclusion. One could reasonably expect that the closest scrutiny of this definition would occur with the largest claims.

There are some work-arounds for this problem, so this is not an insurmountable issue but its not something you should ignore or overlook. If you have an employee you know to have a criminal record or other prior history or have reason to consider hiring one, and would like to have your employee dishonesty policy cover them, call us and we'll see what we can do for you.

Timely Reporting of Claims

Insurance policies usually contain a section defining the policyholder's duties; its particularly important that you understand what your responsibilities are in the event of a claim. With liability policies in particular, which will involve the insurance company's obligation to provide for legal defense of a claim or suit, this duty will include a requirement that claims be reported to the insurance company "promptly" or "...as soon as practicable...", the terms most often found in these types of policies.

Interpreted literally, that requirement means "right now", or as soon as possible after the policyholder was presented with a claim. Certainly in most circumstances that one can imagine a policyholder would be able to forward a claim to his insurer on the same day that it is received. It would only be in rare cases characterized by extraordinary circumstances where the policyholder would be unable to drop a copy of a complaint in the mail the day it was received.

It is, however, a principal of contract law (and insurance policies are contracts, after all) that a contracting party must establish that a breach was "material" before seeking remedies, such as denial of coverage, for a breach of contract terms. Along those lines, an insurance company usually must show that it was prejudiced by the failure of its policyholder to provide timely notice of a liability claim before it may deny coverage on the basis of late notice. Interpreting policy language strictly to exclude coverage for a claim due to a late claim report would violate public policy and create several problems: it would give insurance companies a windfall in premiums without having to provide any agreed upon coverage, it would violate a policyholder's reasonable expectations of coverage and it could harm the victims of an insureds negligence who would be denied proceeds from a policy which might be the largest available source of compensation for their injuries, all due to a harmless breach of a term in the policy.

In fact, this is why courts in most states will not void insurance coverage on the grounds of late notice unless the insurer can establish that it has been prejudiced in some way by the delay in receiving notice of a claim. A minor breach, one that does no harm to the non-breaching party, will not justify either a claim for damages or the rescission of coverage provided under the insurance contract.

These facts so far apply to "occurrence" liability policies, by far the majority of all liability policies written. With these types of policies coverage is triggered by an occurrence that takes place during the policy period. Things are different for policies that are issued on a "claims-made" basis. Under a claims-made policy, coverage will apply only if a claim is both made against the policyholder and reported to the insurance company during the policy period. Put another way, unlike an occurrence policy the insurance company will never be responsible for providing coverage under a claims-made policy for any claim made after the policy expires. Occurrence policies continue to provide coverage and protection long past their expiration date; claims made policies are only useful as wallpaper once they expire.

This fact has a clear and significant impact on claim notice provisions found in claims made policies. The courts of many states have addressed the issue of late reporting in a claims made policy and have generally concluded that the notice provisions of a claims made policy are enforceable. There is no requirement that an insurer show that it was prejudiced by receiving a claim after the expiration of the policy. If a claim against the insured comes in during the policy period and the insurance company only receives notice after the policy has expired, the carrier has a valid and enforceable late-notice defense under a claims-made policy.

The corollary, of course, is that the carrier will not have

such a defense as long as it receives timely notice of a claim during the policy period. What this means to you is that you must know which of your liability policies are written on a claims made basis; typically these will be D&O, Employment Practices, Fiduciary, Errors & Omissions and malpractice types of policies. For these and any other claims made policies you need to be alert to anything that could constitute a claim, and make sure it is reported before the policy expires.

One last caveat: Insurers will also require timely reporting of claims made within the claims made policy period. Here's an example of a common problem with this we often see: a policyholder with an EPL (Employment Practices Liability) policy gets notice of an EEOC action; in most EPL policies, that's a claim. The policyholder, thinking its a minor issue that won't go anywhere or won't exceed the deductible, fails to report it to the insurance company until, months later (but still within the policy period), the big lawsuit arrives. Even though the insurance company may have then been notified of the claim within the policy period, odds are good they'll still invoke the late notice provision and seek to deny coverage.

Bottom line: don't sit on anything that is or could be a claim. If you have any questions about how this might affect you in a particular case, call us.

How to Draft Sound Insurance Requirements

Businesses of all types commonly enter into agreements that contain certain requirements for types of insurance pertinent to the engagement at hand. Whether you are being required to provide evidence of certain types of insurance, or are requiring others to provide it, we usually see certain common errors.

Most commonly its attorneys drafting these contracts. Few attorneys seem to be up to speed on current insurance forms and terminology; it is almost a rule rather than an exception to find insurance terms used in contracts that bear no resemblance to current usage. There are also some common sense do's and don'ts in drafting insurance requirements in contracts that should be kept in mind, whether asking for or giving insurance.

A few common sense pointers:

1. Require insurance that will provide adequate scope of protection needed to cover the primary risks associated with the business relationship the contract describes.
2. Keep insurance requirements as simple, understandable and easy to implement as possible. Minimum coverage requirements should conform to what is commercially available in standard policy forms.
3. Don't ask for something that is not commercially available in the current standard insurance marketplace. Requiring something for which there are no standard forms or endorsements is a recipe for problems.
4. Remember that the other party already has an insurance program in place; assume its a well written and comprehensive program and ask for what you would expect to see in such a program. Try to avoid imposing requirements that would require them to renegotiate their program with their insurers.
5. Allow the other party a reasonable amount of flexibility with respect to how they meet the overall requirements.
6. Recognize the possibility that the requirements could become outdated during the term of the contract due to insurance market changes and policy form revisions, and make allowances for addressing those changes.

Insurance policies and forms are not written in stone, they continuously evolve over time as the insurance industry amends them to reflect new and changing exposures and risks. As new forms are introduced (generally on a three year cycle) and approved by regulators, old forms are withdrawn from use. Contractual insurance requirements that might have been current ten, twenty or more years ago are now antiquated, but attorneys tend to replicate insurance requirements over years or decades and from contract to contract. As a result, obsolete language in contractual insurance requirements seems to be the rule rather than the exception.

Outdated requirements are particularly common for general liability insurance, although they can be found with all types of policies. Here is a list of some of the most commonly seen obsolete insurance terms found just in insurance requirements for general liability policies. Any one of these terms is a red flag:

- Comprehensive general liability insurance
- Public liability insurance
- Manufacturers and contractors (M&C) liability insurance
- Owners, landlords, and tenants (OL&T) liability insurance
- Contractual liability insurance
- Additional named insured
- Coinsured
- Cross-liability endorsement

- Broad form comprehensive general liability (CGL) endorsement
- Broad form property damage endorsement
- Combined single limit (CSL)

These terms are all antiquated and outdated, none are in current usage; if you find them in a set of insurance requirements you are reviewing, or in the requirements you impose on others, its time to make some changes. Give us a call and we'll help you with that.

TRIA Has Expired

The federal terrorism insurance backstop which was originally enacted shortly after 9/11 expired on January 1, 2015; as we went to press it has yet to be renewed by Congress.

Terrorism insurance provides coverage for potential losses to property or people due to acts of terrorism. Loss from terrorist acts has been excluded from most policies since right after 9/11; TRIA was the federal program that allowed underwriters to offer such coverage. Without TRIA such coverage will only be available for higher cost, if at all.

Workers compensation is a different problem, since underwriters can't exclude claims arising from terrorism from a WC policy. A workers compensation insurance policy underwriter has only two options when it comes to addressing a terrorism exposure, either increase the price for mandatory terrorism coverage, or decline to write the policy altogether. If this last option means an employer must go into their state's assigned risk plan or residual market, that's a guaranteed price increase as well as a massive headache and a guarantee of poor service.

As of this writing there appears to be no widespread insurance market impact; the insurance industry is standing pat and banking on fast action from Congress to pass an extension of TRIA. If TRIA is not renewed in the first quarter things could get interesting; stay tuned.

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