RECENT COURT DECISIONS

Contributed by Patrick F. Maroney
Florida State University

Financial Institution Bonds

Empire Bank v. Fidelity and Deposit Company of Maryland, 27 F.3d 333 (8th Cir. 1994)

Randall Walker was the President and Chief Executive Officer of a trucking company. At the request of Walker's wife, Trula, the trucking company bookkeeper issued over $47,000 in checks on the trucking company's account made payable to various household employees of Trula Walker. Mrs. Walker cashed the checks at the Empire Bank, whose official policy was to require endorsement by the presenter of third-party checks. However, Mrs. Walker refused to endorse the checks herself, and the bank waived this requirement at the direction of the bank's vice president.

Mr. Walker cashed over $340,000 worth of checks payable to the trucking company at the Empire Bank. Mr. Walker received either cash or cashier's checks payable to him or to the trucking company. This procedure was contrary to the internal policy of the Empire Bank, which required the bank to have a corporate resolution on file authorizing an individual to cash a corporate check. The trucking company had no corporate resolution on file at the Empire Bank governing this matter.

In 1985, Empire Bank adopted a policy of prohibiting the cashing of checks payable to a corporation. The checks cashed by Mr. Walker were approved for payment by the bank's vice president.

Subsequently, the trucking company filed for bankruptcy. The bankruptcy trustees sued Empire Bank to recover money paid on the checks. Empire Bank settled the claims for $208,735.30. Empire Bank then sought indemnity from its bonding company, Fidelity and Deposit, which denied coverage.

Empire Bank's financial institution bond provided coverage for "forgery or alteration" and "on premises" claims. Coverage was provided for loss of property resulting from "theft, false pretenses, common law or statutory larceny, committed by a person present in an office or on the premises of the insured." The coverage was subject to exclusion for "loss caused by an employee." There was an exception to the exclusion which did provide coverage under the fidelity portion of the bond for certain events such as misplacement, mysterious unexplainable disappearance, or destruction of or damage to property. The trial court found that the Empire Bank's loss was not covered and an appeal ensued.

The appellate court affirmed the trial court, finding that the bond language excluded losses caused by a bank employee and the exclusion for losses caused by an employee did not mean loss caused *solely* by a bank employee. The appellate court wrote, "The district court, in effect, found that the acts of Floyd Tucker (the bank's vice president) was the proximate cause of the loss...suffice it to say that the conduct of the bank officer causing the exclusion to apply would be relevant...therefore the district court correctly found that the bond's exclusion applies and prevents Empire from recovering from Fidelity and Deposit for its loss." Thus, the appellate court upheld the finding that the exclusion in a financial institution bond, which eliminates coverage for loss caused by a bank employee, applies even though the loss was not caused solely by a bank employee.

Pollution Exclusion

Smith v. Hughes Aircraft, 22 F. 3d 1432 (9th Cir. 1993)

In this case, residents in the city of Tucson, Arizona, sued Hughes Aircraft Company for injuries arising out of the contamination of their drinking water. Contamination was the result of Hughes discharging trichlorethylene (TCE) into unlined ponds. Hughes settled the claims for $85,000,000. Several insurers then filed a declaratory judgment action to determine their liability for the claims.

The trial court found for the insurers with respect to policies issued between 1971 and 1985 and later granted summary judgment in favor of the insurers with respect to policies issued between 1956 and 1971. The trial court found that the policy unambiguously excluded pollution risks, not only in aviation policies, but also in the excess CGL policies.

The appellate court found that Hughes presented evidence that its agents understood the exclusion to apply only to aviation risks. Thus, the grant of summary judgment was reversed. Summary judgment should not be granted in instances where there are disputed issues of material fact.

The next issue addressed by the court was the effect of the pollution exclusion found in the 1974 to 1985 policies, which excluded coverage caused by toxic chemicals, liquids, waste materials, or other irritants, among others. However, the exclusion provided, "but this exclusion shall not apply if such discharge dispersal, release, or escape is sudden and accidental." The district court found no coverage because the claimant's injuries were the result of pollution that was not sudden. The term "sudden" incorporates a notion of temporal brevity and does not merely mean unexpected.

The appellate court affirmed. The court found that, under Arizona and California law, nonsudden continuous pollution was not covered. The court rejected Hughes' argument that the pollution occurred when the waste treatment plant broke down or was overcapacitated or when TCE was spilled on the floor and passed into a drain that bypassed the treatment plant and thus was a "sudden" event. The district and appellate courts would not let Hughes convert the gradual pollution caused by long-term waste practices into temporal components.

The court found disputed issues of material fact (thus summary judgment was inappropriate) on the issue of whether Hughes expected or intended injuries within the meaning of California law which precludes liability of insurers for expected injuries.

Cooperation Clause

Shelter Mutual Insurance Company v. Page, 873 S.W. 2d 534 (Ark. 1994)

Brenda Gilbert was injured in an automobile accident with Richard Page, who was insured by Shelter Mutual Insurance Company. Brenda Gilbert filed suit against Page but was unable to obtain personal service on Page so a warning order was published in a newspaper and Page was notified by constructive service. Page did not answer the complaint and was not located thereafter.

Shelter Mutual moved to intervene. A trial was conducted and Page was found to be at fault and liable for the damages sustained by Gilbert. Shelter indicated that Page had breached the policy's cooperation clause by failing to keep Shelter informed of his whereabouts. The trial court found that Page had not breached the cooperation clause and awarded Gilbert damages of $15,000. The insurer appealed.

The Arkansas Supreme Court found that the burden of proof was on the insurer to show that the insured had breached the cooperation clause. The Supreme Court found that the insurer was required to use due diligence to locate an insured or determine the reason for absence from the trial of the insured. In the instant case the court found that Shelter had failed to show that it had made a good faith effort to locate the insured. Thus, because the insurer was not able to show a diligent and good faith effort to locate its insured, the court found that the insured did not breach the cooperation clause.

The court also wrote that the insured had reported the accident in a timely manner and wrote that there was no indication that the insured had failed to disclose required information fully and accurately.

Settlement Without Consent of Insurer, Necessity or Prejudice

Hernandez v. Gulf Group Lloyds, 875 S.W. 2d 691 (Tex. 1994)

Elizabeth Hernandez was killed in November 1987 while riding in a car that flipped over. The driver of the car (McCullough) was negligent in causing the accident. The driver was 19 years old and carried bodily injury liability coverage in the amount of $25,000 with State Farm Mutual. The victim was covered as an insured under her parents' policy, which provided $100,000 in uninsured/underinsured motorist coverages.

After the accident, the parents of the victim entered into a settlement with the driver for $25,000 (the policy limit). The Hernandezes then sought to collect from Gulf under the underinsured motorist coverage. However, Gulf denied coverage because the Hernandezes did not obtain the consent of Gulf prior to settling with McCullough.

The trial court awarded the Hernandezes $100,000 plus interest and attorney's fees. The trial court found that the insurer had suffered no prejudice even though the Hernandezes had failed to comply with policy provisions which required Gulf's consent before settling. The court of appeals reversed and the case was appealed to the Supreme Court.

The Supreme Court wrote that the insurer may escape liability on the basis of the settlement without consent exclusion only when the insurer is actually prejudiced by the insured's settlement. The court found that the failure of the Hernandezes to obtain the consent of the underinsured motorist carrier prior to settling with the tortfeasor was "not a material breach." The court found that the insurer had stipulated that it knew of no case where it had refused consent to settle a claim when an underinsured driver had tendered the full limits of the policy. Additionally, the parties had stipulated that the tortfeasor had no assets other than the $25,000 State Farm policy and that Gulf had not incurred any financial losses with regard to subrogation rights.

The dissent indicated that the case was not about breach of contract, but rather was about coverage. The dissent also indicated that the result of the majority opinion would be that insureds would be in a position to settle as quickly as possible with the tortfeasor and then, at a later date, make a claim against their underinsured motorist policy. The insurer would be unaware of the fact that it would need to investigate the negligent person and determine whether that person was judgment proof. The dissent also pointed out that the insurer will have difficulty in proving prejudice years after the accident.