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Lawyer Insights

Compliance, crimes, and coverage: Mitigating risk through employee theft coverage

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When employees violate internal policies that result in losses to their employers and clients, compliance, risk management, in-house counsel, and other key personnel are often left scrambling to do damage control. A recent federal appeals court opinion demonstrates how crime insurance policies can step up and provide both recovery for those losses and peace of mind for those responding to the incident. In particular, employee theft coverage within crime policies can insure policyholders against not only employee misconduct but also much of the downstream effects those actions can have on the company's bottom line. This article provides a summary of how companies can incorporate crime insurance policies into their compliance and risk management programs and the benefits they can receive as a result.

Summary of the Cargill case at the Eighth Circuit

Cargill is a global food corporation specializing in producing, transporting, and trading agricultural commodities like grain and livestock. The company purchased a commercial crime insurance policy containing a coverage grant for "Employee Theft."[1] The policy covered "theft," which was defined as "the unlawful taking of property to the deprivation of the Insured." The policy also provided that Cargill's loss must have resulted "directly from" employee theft. A long-tenured employee at one of Cargill's grain facilities in New York oversaw portions of the grain storage and rail transportation operations. She developed a scheme to embezzle money from Cargill by internally misrepresenting the price at which she could sell the grain in the Albany market, causing Cargill to ship excess grain to Albany. The employee then entered false sales contracts into Cargill's accounting system and manipulated the system to show grain sales at prices higher than those for which the grain actually sold.

Upon discovering this scheme, Cargill notified its insurer and cooperated with the subsequent investigation. All told, Cargill had suffered approximately $32 million in losses—$3 million the employee embezzled plus $29 million in excess freight costs from surplus grain shipments to Albany. However, the insurer agreed to cover only those funds the employee embezzled and denied coverage for the excess freight costs.

Seeking affirmation of its partial denial of coverage, the insurer filed suit in Minnesota federal court. Cargill prevailed in an early motion asking the trial court to determine if it had sustained covered losses resulting directly from the employee's misconduct. The court agreed with Cargill, awarding both the $3 million the employee stole as well as the $29 million in costs.

The Eighth Circuit affirmed the trial court's ruling. On appeal, the insurer argued that the employee's conduct was not a "taking" of the grain, as required by the employee theft insuring agreement. The court rejected that claim, recognizing that the employee's "implicit control" over the grain, including by controlling the pricing and recordkeeping elements of the sale, was sufficient to constitute an unlawful taking under the policy and did not require physical seizure of the products.

The insurer also argued that Cargill's loss of $29 million in freight costs did not result "directly from" the employee's conduct since those two occurrences were too disjointed in the causal chain. The Eighth Circuit also dispatched that argument, agreeing with the trial court that Cargill would not have paid the freight costs if not for the employee's scheme and that no other intervening causes could account for those losses. As a result, the court agreed that Cargill had shown that the employee's conduct constituted "employee theft" under the crime insurance policy and that its losses resulted directly from that theft. Cargill's victory, which centered around the meaning of "employee theft" under commercial crime policies and the scope of recoverable damages flowing from employee theft, can provide guidance for analyzing coverage for other claims redressing similar losses. The remainder of this article explains how.

Crime policies offer varied definitions of "theft"

When employee misconduct evades compliance measures, crime insurance policies can alleviate the stress and financial impact on the employer. As with any insurance policy, the best place to begin understanding the scope of coverage is the policy language itself. Crime policies can include wide-ranging types of coverage for things like employee theft, forgery, counterfeiting, computer crime, fund transfer fraud, and identity fraud. Different policy forms issued by other insurers may present superficial similarities, but upon closer inspection, it quickly becomes clear that certain terms and conditions vary widely between policies.

For instance, in the employee theft context, these excerpts from different policies appear to provide comparable grants of employee theft coverage (see Table 1).

Table 1: Policy excerpts

Policy #1	Policy #2
The Underwriter will pay for loss of or damage to Money, Securities, or Property sustained by the Insured resulting directly from Theft or Forgery committed by an Employee, whether identified or not, acting alone or in collusion with other persons.	The Insurer will pay for loss of or damage to Money, Securities, and Other Property resulting directly from Theft committed by an Employee, whether identified or not, acting alone or in collusion with other persons.

Despite significant similarities between these two insuring agreements, the actual coverage they provide can diverge based on how each term—like money, theft, or employee—is defined. At first glance, one might expect that terms like "theft" or "forgery" would cover only a limited subset of conduct that falls within the traditional meaning of those acts. However, insurers can define these terms and policies in many ways—either more broadly to include additional conduct or more narrowly to exclude specific acts that might otherwise appear germane. In theory, the permutations are limitless since insurers can offer any number of variations; it is up to the insurer to employ clear and precise language that conveys whatever meaning is intended. In practice, however, this model of clarity is not always achieved, so crime policies may require compliance personnel, risk managers, and in-house counsel to conduct a more thorough review of their policies and analyze the breadth of coverage actually available should a claim arise.

Cases like Cargill are relatively easy on this point. The rogue Cargill employee embezzled money by lying to the company and creating false sales contracts. Embezzlement fits cleanly in the meaning of "theft" in Cargill's policy, which defined the term as "the unlawful taking of property to the deprivation of the Insured."

Other cases are not as simple. For instance, a Texas state appellate court reversed the trial court and ruled that a tax firm was entitled to coverage under its employee theft provision.[2] There, an employee had falsified tax return information on behalf of the firm's clients, fraudulently producing favorable results that translated into larger commissions for that employee. The company and insurer agreed that the employee did not earn the commissions he received, but they disputed whether his conduct constituted theft under the policy. The policy defined theft as "the unlawful taking of Money . . . to the deprivation of the Insured." Because the employee's misconduct enabled him to take from his employer money he was not entitled to, the court determined that there was an "unlawful taking" as required under the policy. The fact that the employee pleaded guilty to mail fraud and money laundering—but not theft or similar larceny-type offenses, as raised by the insurer—had no bearing on the court's determination of whether a theft had occurred as defined in the policy. The employee's engaging in misconduct to receive money to which he was not otherwise entitled was sufficient to trigger coverage.

On the other hand, a New York federal court denied coverage due to a "Special Employee Theft Exclusion" contained within the "Employee Theft" portion of the policy. In that case, hotel owners entered into a management agreement with a third party.[3] The owners subsequently learned that a former manager—the sole member and manager of the third-party entity—had stolen over $700,000 by depositing checks made out to the hotels into his own bank account. Quite like the policy excerpts listed above, the policy in this case offered coverage for loss resulting directly from "theft" committed by employees. Critically, the policy also contained a "Special Employee Theft Exclusion" that barred coverage for losses resulting from theft or any dishonest act committed by any named insured in the policy. Because the wrongdoer was a named insured and the former manager was the sole member, the claim fell within the special exclusion, and the owners could not recover the stolen funds.

These cases show the varied outcomes that can result based on different policy languages. Policy definitions, for example, can cover a broader array of people, claims, or conduct than one might anticipate based on the undefined meaning of the same term. As a result, employee misconduct may still trigger employee theft coverage even when it does not fall neatly into the ordinary conception of theft. Crime insurance policies purchased to protect against employee theft, therefore, can serve as a crucial backstop to a company's existing compliance safeguards by providing an additional layer of protection from the losses caused by their employees. Compliance, risk management, and legal personnel should carefully scrutinize their employee theft coverage to ascertain what conduct will actually be covered.

Recovery extends beyond the employee's direct benefit

Once a policyholder demonstrates it is entitled to employee theft coverage under its crime policy, the analysis turns to the quantum of recoverable damages. As shown in the two excerpts above, policies frequently cover losses "resulting directly from" the covered misconduct. Policies typically do not define this phrase, leaving the policyholder and insurer to argue over how "direct" the link between the underlying misconduct and resulting losses must be. The good news for policyholders is that courts often employ a broad causation analysis in determining the scope of recoverable losses tied to employee theft.

This inquiry headlined the dispute in Cargill. All parties agreed that the embezzled funds were insured, but the insurer contested whether the associated—and significantly heftier—freight costs should be included. The company argued that the employee "exercised her authority to direct the transfer and sale of the grain," causing Cargill to incur the freight costs as a direct result of her misconduct; the insurer countered that the employee's actions did not amount to a "taking" of the grain.

The court's well-reasoned analysis took a commonsense approach, consistent with governing law and the majority view that undefined words in an insurance policy should be given their everyday meaning. To do so, the court relied on a dictionary to define "directly" as "in a straightforward manner," "in a straight line or course," or "immediately." With this framing in mind, the court concluded that Cargill would not have incurred those costs if not for the employee's scheme, and there was "no other intervening cause that could account for that loss." Thus, the causal chain was sufficiently connected to bring the freight costs within the scope of coverage.

In the Texas case, while the appellate court could not resolve every issue pertaining to the unearned commissions with the record it received on appeal, it identified the same types of questions for remand as those addressed in Cargill. Specifically, the trial court still needed to resolve whether the refunds that the tax firm issued to clients, the money it paid to Texas authorities, and the expenses it incurred in investigating the fraud "were losses 'resulting directly from'" the covered employee theft. The parties will need to analyze whether there is a sufficient nexus between the unearned commissions scheme and the subsequent costs to bring the losses within coverage.

The New York case posed the same questions even though under that particular set of facts, it resulted in no coverage for the claim. The hotel owners argued that the exclusion should not apply because the wrongdoer had committed the theft in his individual capacity and not in his capacity as a former manager of the insured entity. The court sided with the insurer, given the presence of a special exclusion restricting coverage for claims involving employees of insured entities.

Outside the context of employee theft claims, there is ample support for the policyholder position favoring broad recoveries based on comparable analyses in other types of insurance disputes. For example, the Indiana Supreme Court construed the phrase "resulting directly from" in the insurance context to mean "proximately without significant deviation."[4] There, the policyholder sought coverage for Bitcoin it transferred to regain control of the company's computer systems after a ransomware attack. The policy required losses "resulting directly from the use of a computer," but the insurer denied coverage on the grounds that the company's voluntary transfer of Bitcoin was an intervening cause that severed the causal chain of events. However, the court deemed that interpretation too narrow, instead interpreting "resulting directly from" to require proof by the policyholder that its loss resulted either "immediately or proximately without significant deviation from the use of a computer." Even where the policyholder consulted with the Federal Bureau of Investigation and other tech experts and initiated contact with the hackers to negotiate the release of its servers after the computer systems were encrypted, the court nevertheless found that the company's transfer of Bitcoin was nearly the immediate result without significant deviation from the use of a computer. Therefore, the policyholder was entitled to coverage. Other courts have adopted similar positions on causation supporting broad recovery.

This consistency in interpretation across different types of insurance offers credibility in arguing that additional costs should be swept within the coverage grant. It shows that policyholders are not contorting policy language to fit their narrative but rather applying basic rules of construction to reach commonsense conclusions. That contrasts with some policy interpretations advocated by insurers that may be consistent with what the insurer intended but are not actually supported by the language used in drafting the policy—precision in drafting matters. Courts rightfully reject attempts to rewrite the insurance contract to afford narrower coverage or enforce broader exclusions than what the policy language supports. If policyholders can demonstrate that employee theft coverage applies to the original misconduct at issue, they can leverage favorable damages/causation opinions to achieve earlier resolution with their insurer or bolster their arguments in litigation.

Conclusion

At minimum, compliance and risk management personnel tasked with evaluating potential coverage for insurance claims under the company's crime policy should not assume that they are limited to recovering the contents of the proverbial safe that their employee stole under an employee theft provision. Crime policies can and often do cover damages more broadly, mitigating operational risks and reducing the impact that employee misconduct has on the company when compliance measures are unable to detect the initial malfeasance. Companies and their officers, directors, and in-house counsel should consult coverage counsel on how best to implement insurance coverage as part of a robust risk mitigation strategy to work alongside existing compliance programs, ensuring that additional safeguards are in place to protect the company from exposures arising from employee misconduct.

Takeaways

- Companies can use crime insurance policies as one risk management strategy to mitigate the impact of employee misconduct.
- Crime insurance policies are not one-size-fits-all, so the devil is in the details in assessing how the policy language operates under each set of facts.
- Even when it does not fall neatly into the ordinary conception of theft, employee misconduct may still trigger employee theft coverage.
- Courts often permit recovery of losses for costs tied to employee theft, not just the amount that the employee received as a benefit.
- Companies should resist the efforts of insurers to reduce the scope of recovery or otherwise distance downstream losses from the misconduct that caused them.

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Notes

1.) Nat'l Union Fire Ins. Co. of Pittsburgh v. Cargill, Inc., 61 F.4th 615 (8th Cir. 2023).

2.) Ryan LLC v. National Union Fire Insurance Co. of Pittsburgh, Pa., No. 05-22-00286-CV, 2023 WL 2472889 (Tex. Ct. App. Mar. 13, 2023).

3.) Albany Airport HIE, LLC v. Hanover Ins. Grp., Inc., 391 F. Supp. 3d 193 (N.D.N.Y. 2019).

4.) G&G Oil Co. of Ind., Inc. v. Cont'l W. Ins. Co., 165 N.E.3d 82 (Ind. 2021)

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