

Series of Employee Thefts Constitute Interrelated Acts Barred from Coverage By Insured's Prior Knowledge

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Applying Virginia law, the United States District Court for the Eastern District of Virginia has granted summary judgment on behalf of an insurer, holding that a series of employee thefts constituted interrelated acts and that coverage for the resulting claim is precluded by the prior knowledge condition of the policy's coverage agreement. *Bryan Brothers, Inc. v. Cont. Cas. Co.*, No. 3:09-CV-675 (E.D. Va. March 25, 2010). Wiley Rein LLP represented the insurer in this litigation.

The insurer issued an accountants' professional liability policy to the insured, an accounting firm. The insuring agreement included a prior knowledge condition that, prior to the policy's effective date, no insured had a basis to believe that any act or omission, or interrelated act or omission, might reasonably be expected to be the basis of a claim under the policy. The policy defined "interrelated act or omission" as acts that are "logically or causally connected by any common fact, circumstance, situation, transaction, event, advice or decision." The policy also included an "innocent insured" provision that saved coverage for innocent insureds if coverage under the policy would be excluded as a result of any "dishonest, illegal, fraudulent, criminal or malicious act" of another insured.

An employee of the accounting firm, who was an insured under the policy, committed a series of thefts from the firm's clients beginning several years prior to the policy's effective date. One of the thefts occurred after the policy's effective date. The employee accomplished all of the thefts by drafting checks drawn on the clients' accounts or endorsing checks made payable to the clients and concealed all of the thefts by manipulating the firm's financial records. Upon discovery, the thefts resulted in multiple demands from the firm's clients.

The court held that the prior knowledge condition to the insuring agreement precluded coverage for the thefts. First, the court found as a matter of law that a reasonable person who had embezzled client funds would have a basis to believe that such acts "might reasonably be expected to be the basis of a claim" under a professional liability policy. Since the embezzler indisputably was an insured under the policy, the prior knowledge condition barred coverage. Second, the court found that the innocent insured provision saved coverage for innocent insureds only where coverage was barred because of the policy's exclusion for

"dishonest, illegal, fraudulent, criminal or malicious acts." The provision was inapplicable here because coverage was barred by an insured's prior knowledge rather than by the policy's dishonesty exclusion.

The court then held that all of the thefts constituted "interrelated acts or omissions" such that the prior knowledge condition also precluded coverage for the single theft that occurred after the policy's effective date. The court found that the term "interrelated acts or omissions" was unambiguous and that all of the thefts were "logically or causally connected" because they involved the same scheme by the same employee using the same modus operandi to accomplish and to conceal the thefts. These common ties led the court to the "inescapable conclusion" that the thefts constituted interrelated acts for which coverage was unavailable under the policy.