

1989

Home Savings and Loan, a Utah corporation v. The Aetna Casualty and Surety Company : Reply Brief

Utah Court of Appeals

Follow this and additional works at: https://digitalcommons.law.byu.edu/byu_ca1

 Part of the [Law Commons](#)

Original Brief Submitted to the Utah Court of Appeals; digitized by the Howard W. Hunter Law Library, J. Reuben Clark Law School, Brigham Young University, Provo, Utah; machine-generated OCR, may contain errors.

Gary R. Howe; P. Bryan Fishburn; Callister, Duncan & Nebeker; Attorneys for Plaintiff/
Respondent/Cross-Appellant.

Lynn S. Davies; Russell C. Fericks; Richards, Brandt, Miller & Nelson; Attorneys for Defendant/
Appellant.

Recommended Citation

Reply Brief, *Home Savings and Loan v. The Aetna Casualty and Surety Company*, No. 890101 (Utah Court of Appeals, 1989).
https://digitalcommons.law.byu.edu/byu_ca1/1601

This Reply Brief is brought to you for free and open access by BYU Law Digital Commons. It has been accepted for inclusion in Utah Court of Appeals Briefs by an authorized administrator of BYU Law Digital Commons. Policies regarding these Utah briefs are available at http://digitalcommons.law.byu.edu/utah_court_briefs/policies.html. Please contact the Repository Manager at hunterlawlibrary@byu.edu with questions or feedback.

BRIEF

UTAH
DOCUMENT
KFU

50

.A10

DOCKET NO. 89-101 CA

IN THE COURT OF APPEALS OF THE STATE OF UTAH

HOME SAVINGS AND LOAN, a Utah
corporation,)

Docket No. 890101-CA

Plaintiff/Respondent
and Cross-Appellant,)

[Priority 14(b)]

v.)

THE AETNA CASUALTY AND SURETY
COMPANY,)

Defendant/Appellant.)

REPLY BRIEF

LYNN S. DAVIES [A0824]
RUSSELL C. FERICKS [A3793]
RICHARDS, BRANDT, MILLER
& NELSON
Attorneys for Defendant/
Appellant The Aetna
Casualty & Surety Co.
Key Bank Tower, Seventh Floor
50 South Main Street
P.O. Box 2465
Salt Lake City, Utah 84110
Telephone: (801) 531-1777

GARY R. HOWE
P. BRYAN FISHBURN
CALLISTER, DUNCAN & NEBEKER
Attorneys for Plaintiff/
Respondent/Cross-Appellant
Home Savings & Loan Association
800 Kennecott Building
Salt Lake City, Utah 84133
Telephone: (801) 530-7300

AUG 6 1990

Mary T. Noonan
Clerk of the Court

IN THE COURT OF APPEALS OF THE STATE OF UTAH

HOME SAVINGS AND LOAN, a Utah)	
corporation,)	Docket No. 890101-CA
)	
Plaintiff/Respondent)	[Priority 14(b)]
and Cross-Appellant,)	
)	
v.)	
)	
THE AETNA CASUALTY AND SURETY)	
COMPANY,)	
)	
Defendant/Appellant.)	

REPLY BRIEF

LYNN S. DAVIES [A0824]
RUSSELL C. FERICKS [A3793]
RICHARDS, BRANDT, MILLER
& NELSON
Attorneys for Defendant/
Appellant The Aetna
Casualty & Surety Co.
Key Bank Tower, Seventh Floor
50 South Main Street
P.O. Box 2465
Salt Lake City, Utah 84110
Telephone: (801) 531-1777

GARY R. HOWE
P. BRYAN FISHBURN
CALLISTER, DUNCAN & NEBEKER
Attorneys for Plaintiff/
Respondent/Cross-Appellant
Home Savings & Loan Association
800 Kennecott Building
Salt Lake City, Utah 84133
Telephone: (801) 530-7300

TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION	1
A. The Standard Form 22 Bond Provides Indemnification Only Against an Employee's Dishonest and Criminal Acts Resulting in Loss	1
B. Aetna's Primary Arguments are Interconnected and Mutually Consistent with the Purpose of Standard Form 22	4
C. Rules of Interpretation of Bonds	6
POINT I	
SECTION 11 OF THE BOND PRECLUDES COVERAGE FOR LOSS FROM LARRY GLAD'S CONDUCT BECAUSE HOME SAVINGS LEARNED OF HIS DISHONESTY SEVEN MONTHS BEFORE THE BOND WAS PURCHASED	8
A. The Correct Judicial Application of Section 11	9
B. The Error in Home Savings' Analysis	11
POINT II	
THERE IS NO COVERAGE UNDER THE BOND BECAUSE HOME SAVINGS DISCOVERED ITS LOSS OUTSIDE THE AETNA BOND PERIOD	16
A. Trial Court's Error	16
B. The Language of Standard Form 22	18
C. Timing of Insured's Actual Loss or Damages is not Relevant	20
D. Home Savings' Discovery of Loss as a Matter of Law	22

POINT III

THE JURY'S RESPONSES TO SPECIAL INTERROGATORIES 2 AND 4 REGARDING HOME'S MISREPRESENTATIONS IN THE APPLICATION PROCESS MANDATE A VOIDING OF THE BOND	25
A. Home's Material Misrepresentation on the Bond Application: U.C.A. 31-19-8(1)(b)	28
B. Aetna's Subjective Reliance on Home's Misrepresentations on the Application (U.C.A. 38-19 - 8(1)(c))	30
C. Home Had a Duty to Volunteer Information Material to the Risk Insured	31
D. The Issue Was Properly Preserved for Trial and is Ripe for Appellate Review	32
E. Aetna May Rescind Coverage with Respect to Larry Glad only or it May Rescind the Entire Bond	34

POINT IV

THE TRADING EXCLUSION VOIDS COVERAGE UNDER THE BOND FOR LOSSES ON THE AFCO INVESTOR LOANS	38
A. Trial Court Made Improper Legal Interpretation and Application of Rider 6030a	38
B. The Issue was Properly Presented to the Trial Court and Preserved for Appeal	41

POINT V

THE COURT ERRED IN REFUSING TO ALLOW THE JURY TO CONSIDER HOME'S BAD BUSINESS JUDGMENT AND MISMANAGEMENT AS CAUSES OF THE AFCO INVESTOR LOSSES	43
---	----

A.	Home's Losses were Caused by its Own Management Decision	44
B.	Aetna Properly Preserved the Jury Instructions and Special Verdict for Review on Appeal	46
	1. Proposed Jury Instructions No. 2 and No. 42	47
	2. Objectionable Jury Instructions Nos. 26-30	48
	3. Special Verdict Form	48
	4. Review of Error by Court of Appeals . . .	49
C.	Aetna Was Prejudiced by the Special Verdict Form and the Jury Instructions as Given	50
POINT VI		
	WITHOUT F&D MARYLAND AS A PARTY, COMPLETE RELIEF WAS NOT AVAILABLE TO AETNA . . .	51
POINT VII		
	A JUDGMENT MUST ACCURATELY REFLECT THE ACTUAL DAMAGES PROVEN AT TRIAL	52
POINT VIII		
	HOME SAVINGS IS NOT ENTITLED TO INDEMNIFICATION FOR THE LEGAL FEES AWARDED TO THE <u>ARMITAGE</u> PLAINTIFFS NOR THE ENTIRE AMOUNT OF COURT COSTS AND ATTORNEYS' FEES INCURRED IN DEFENDING THE <u>ARMITAGE</u> LITIGATION	55
A.	Home Savings is not Entitled to Indemnification of Legal Fees Awarded to the <u>Armitage</u> Plaintiffs	55

B.	Home Savings May Not be Awarded Legal Fees Incurred in Defending the <u>Armitage</u> Litigation for Losses That are Not Covered by the Bond	56
CONCLUSION		57

TABLE OF AUTHORITIES

	<u>Page</u>
<u>Cases</u>	
<u>Alfalfa Elec. Coop., Inc. v. Travelers Indemn. Co.,</u> 376 F.Supp. 901 (W.D. Okla. 1973)	8
<u>Beck v. Farmers Ins. Exchange,</u> 701 P.2d 795 (Utah 1985)	27
<u>C. Douglas Wilson & Co. v. Insurance Co. of</u> <u>North America,</u> 590 F.2d 1275 (4th Cir. 1979), <u>cert.</u> <u>denied,</u> 444 U.S. 831 (1979)	10, 12, 13
<u>C. Douglas Wilson & Co. v. Insurance Co. of</u> <u>N. Am.,</u> 464 F. Supp. 1, 17 (D.S.C. 1977), <u>aff'd.,</u> 590 F.2d 1275 (4th Cir. 1979), <u>cert. denied,</u> 444 U.S. 831 1929	35, 52
<u>Calcasieu-Marine National Bank v. American</u> <u>Employers' Insurance Co.,</u> 533 F.2d 290 (5th Cir. 1976) <u>cert. denied,</u> 429 U.S. 922, 97 S. Ct. 319, 50 L. Ed. 2d 289 (1976)	8
<u>Central Progressive Bank v. Fireman's Fund Ins. Co.,</u> 658 F.2d 377 (5th Cir. 1981)	20
<u>Collins v. Pioneer Title Ins. Co.,</u> 629 F.2d 429 (6th Cir. 1980)	32
<u>Continental Corp. v. Aetna Casualty & Surety Co.,</u> 892 F.2d 540 (7th Cir. 1989)	2
<u>Dairyland Ins. Co. v. Kammerer,</u> 327 N.W.2d 618 (Neb. 1982).	36
<u>Disanto v. Enstrom Helicopter Corp.,</u> 489 F. Supp. 1352 (1980).	37
<u>Employer's Mut. Liab. Ins. Co. of Wisconsin v. Allen</u> <u>Oil Co.,</u> 258 P.2d 445 (Utah 1953)	46
<u>Everhart v. Drake Management Inc.,</u> 627 F.2d 686 (5th Cir. 1980)	54

<u>Farrington v. Granite State Fire Ins. Co. of Portsmouth</u> , 232 P.2d 754 (Utah 1951)	36
<u>Fidelity & Casualty Co. v. Central Bank of Houston</u> , 672 S.W.2d 641 (Tex. App. 1984).	11, 14, 15
<u>First National Bank of Bowie v. Fidelity and Casualty Co. of New York</u> , 634 F.2d 1000 (5th Cir. 1981)	16, 21, 24
<u>First Natl. Bank of Fleming v. Maryland Casualty Co.</u> , 581 P.2d 744 (Colo. Ct. App. 1978)	16, 21
<u>Hardy v. Prudential Ins. Co.</u> , 763 P.2d, 761 (Utah 1988)	26, 30
<u>Home Indemnity Co. v. Reynolds & Co.</u> , 187 N.E.2d 274 (Ill. App. 1963)	45
<u>Home Life Ins. Co. v. Clay</u> , 13 Kan. App. 2d 435, 773 P.2d 666 (1989)	19, 20
<u>Kiahtipes v. Mills</u> , 649 P.2d 9 (Utah 1982)	27
<u>LDS Hospital v. Capitol Life Insurance Co.</u> , 765 P.2d 857 (Utah 1988)	7
<u>Levey v. Jamison</u> , 82 F.2d 958 (4th Cir. 1936)	1, 45
<u>Pagan v. Thrift City, Inc.</u> , 460 P.2d 832 (Utah 1969)	46
<u>Perry v. Woodall</u> , 438 P.2d 813 (Utah 1968)	36
<u>Ritchie Grocer Co. v. Aetna Casualty & Sur. Co.</u> , 426 F.2d 499 (8th Cir. 1970)	8, 10
<u>Robertson v. Farm Bureau Mutual Ins. Co. of Arkansas</u> , 668 F. Supp. 1259 (W.D. Ark. 1987)	37
<u>Royal Trust Bank v. National Union Fire Insurance Co.</u> , 788 F.2d 719 (11th Cir. 1986)	19, 20
<u>Sharp v. Federal Savings and Loan Insurance Corp.</u> , 858 F.2d 1042 (5th Cir. 1988)	3, 6, 7

<u>Shearson/American Express v. First Continental Bank & Trust Co.</u> , 579 F. Supp. 1305 (W.D. Mo. 1984)	39
<u>Startin v. Madsen</u> , 237 P.2d 834 (Utah 1951)	48
<u>St. Joe Paper Co. v. Hartford Accident and Indemnity Co.</u> , 359 F.2d 579 (5th Cir. 1966)	10, 14
<u>State Street Bank v. U.S.F.&G.</u> , 539 N.E.2d 779 (Ill. App. 4 Dist. 1989)	45
<u>State v. Tolman</u> , 775 P.2d 422 (Utah Ct. App. 1989)	30
<u>Stipcich v. Metropolitan Life Insurance Co.</u> , 277 U.S. 311 (1928)	31, 32
<u>Sutro Bros & Co. v. Indemnity Insurance Co. of North American</u> , 264 F. Supp. 273 (S.D. N.Y. 1967)	40, 41
<u>Verex Assurance, Inc. v. J. Hanson Sav. & Loan</u> , 816 F.2d 1296 (9th Cir. 1987),	36
<u>Verneco, Inc. v. Fidelity & Casualty Co.</u> , 219 So. 2d 508 (La. 1969)	9, 10
<u>Watters v. Querry</u> , 626 P.2d 455 (Utah 1981)	46

Statutes and Rules

Utah Code Annotated 31-19-8(1) (1974)	25, 26, 28, 30
Rule 19, Utah Rules of Civil Procedure	51
Rule 51, Utah Rules of Civil Procedure	49
Rule 54(b), Utah Rules of Civil Procedure	41

Treatises

35 Am. Jur. 2d <u>Fidelity Bonds and Insurance</u> 3, p. 505 (1967)	8
---	---

I N T R O D U C T I O N

A. The Standard Form 22 Bond Provides Indemnification Only Against an Employee's Dishonest and Criminal Acts Resulting in Loss.

The contract at issue in this case is a standardized Savings and Loan Bond, Form 22. Through the Bond, Aetna and Home Savings entered into a contract of indemnification to replace identical Standard Form 22 coverage previously issued by Fidelity & Deposit of Maryland ("F&D"). Standard Form 22 provides a variety of coverages; however, the coverage involved in this case was indemnification for losses caused or "resulting directly from" employee dishonesty, as that term is defined in the contract. (Aetna Bond, Tr. Ex. 343, Rider 6041.) That provision of the Aetna Bond covered losses "sustained by [Home Savings] at any time but discovered during [Aetna's] Bond Period." (Id., Preamble.)

The purpose of Standard Form 22 is to protect a Savings and Loan "against the dishonesty or crime of its employees." Levey v. Jamison, 82 F.2d 958, 960 (4th Cir. 1936). It does not cover losses caused by the business practices or strategies of Home Savings itself. Id. "The bond is aimed at covering losses that employees intend to cause their employer, not losses involving fraudulent practices directed against customers that serve to benefit an employer

acting in concert with the employee." Continental Corp. v. Aetna Casualty & Surety Co., 892 F.2d 540, 549 n. 5 (7th Cir. 1989).

The Bond is a cohesive, integrated document. Its multiple provisions intentionally allocate to the insured and the insurer a defined set of risks and responsibilities. The Bond's bright line definition of dishonesty avoids previously common disputes about what constituted employee dishonesty. (Rider 6041.) By requiring the insurer to reimburse the savings institution for "losses sustained at any time" but only if they were caused by dishonesty "discovered during the bond period," Standard Form 22 prevents allocating to one insurer the consequences of risks covered by a prior carrier's bond. (Preamble and Section 9.) By imposing objective and per se tests to determine when discovery occurs, and by requiring timely notice as soon as practical to the proper carrier, disputes about who was the proper insurer are minimized. (Section 4 and Rider 6091.)

Even more particularly, although the Bond generally covers all employees, the parties agreed in advance that when the insured gains knowledge of the dishonest acts of an employee then coverage for that employee immediately terminates. (Section 11.) By allocating to the insured the risk of hiring or continuing employment of a dishonest employee, the Bond discourages such a foolish practice. By the

Bond's express proximate cause requirement (Rider 6041), the insured is discouraged from allowing the root problem of dishonesty to be compounded by losses that more accurately reflect poor management, or improper response to the discovery of employee dishonesty.

Early discovery of dishonesty, early warning to the proper surety, and prudence in deciding whether to allow a dishonest employee to begin or continue employment at a Savings and Loan, are valid goals. In pursuit of these objectives, both parties agree in Standard Form 22 to terms with established meanings to both the surety industry and the savings and loan industry. See Sharp v. Federal Savings & Loan Ins. Corp., 858 F.2d 1042, 1046-47 (5th Cir. 1988). When those terms are properly applied in order to achieve the intended results, the insured should not be heard to claim ambiguity or to offer strained interpretations that frustrate the risk-allocating functions which those provisions serve.

Furthermore, because an insured can obtain on-going coverage under Standard Form 22 from successive sureties, both public policy and the provisions of Form 22 require that the insured provide pertinent information to the new carrier before expecting uninterrupted coverage. Where a subsequent bond is purchased to provide unbroken coverage under Standard Form 22, the insured must inform the new bonding company (here, Aetna) of those facts which it should have provided to the surety

under the previous bond (F&D). Fundamentally, an insured cannot improve its position or obtain broader coverage than it had under a previous bond by changing sureties or by entering into a new Standard Form 22 contract.

B. Aetna's Primary Arguments are Interconnected and Mutually Consistent with the Purpose of Standard Form 22.

From the very outset of this case, as evidenced by Aetna's early motion to add Home's prior bond carrier (F&D) as a necessary party, Aetna has contended that if Standard Form 22 coverage was available to Home, it was under F&D's bond. In any event, several specific provisions of Aetna's Bond absolutely preclude Home's claims for coverage from Aetna.

Home's management knew it had a dishonest employee and had fired him seven months before it applied for the Bond (Point I). Management knew that its employee was involved in a series of unusual loans which had been previously approved by management and which were going bad before Home contracted with Aetna (Point II). Management failed to provide timely notice in order to lock in coverage under F&D's bond (Point VI). Instead, Home's management speculated on the outcome of these events and did not notify F&D or inform Aetna until months after the Bond was in place that the AFCO investors had filed suit and were being sued by Home, or that Home was already booking losses related to the investor loans (Point III). At trial, there was ample evidence that Home's management, by

voluntarily entering into an intimate business relationship with the Grant Affleck companies on a speculative investment scheme, was the primary or overriding cause of the loss (Point V).

Aetna's consistent analysis also applies to the other issues raised on appeal. The AFCO investor losses resulted from a business decision involving trading in securities, a risk specifically excluded under the Aetna Bond (Points IV and VIII). In addition, even given the trial court's unwaivering efforts to find coverage, the court improperly refused to grant Aetna an offset for the financial benefit which Home received from its participation in the AFCO scheme (Point VII). In bringing this action, Home's management has tried to evade its responsibility for the losses by using Larry Glad as a scapegoat. Home seeks to shift the burden of the losses to Aetna, which came on the scene long after the occurrence of all pertinent events and without knowledge of any relevant facts. The points raised in Aetna's brief are alternative legal means to prevent Home's legal subterfuge and to arrive at a just result, giving effect to the jury's intention that Home Savings should bear the burden of its own business decisions.

This appeal is necessary in order to correct fundamental errors made by the trial court in its refusal to enforce the terms of the parties' Standard Form 22 fidelity contract. In ruling as it did, the trial court condoned the

practice of postponing notice of dishonesty to the prejudice of a surety which is informed of the risks only after a new policy has been issued; it confused the consequences of employee dishonesty with the consequences of bad management; and it expanded the coverage of the insurance contract beyond its actual and intended terms.

C. Rules for Interpretation of Bonds.

In its responsive brief, Home Savings does not dispute the established rules of insurance contract enforcement. (See Appellant's Brief at 27-29.) Instead, Home claims that the Bond contains ambiguous provisions and that ambiguity must be construed in favor of the insured. This general rule of construing ambiguous terms in favor of the insured does not apply in the present context for two reasons. First, Standard Form 22 is not ambiguous. Many courts have considered the Standard Form 22 and found it to be unambiguous. See, e.g., Sharp, 858 F.2d at 1044-46. Home identifies no ambiguities in the contract itself, and only implies ambiguity in the Bond application. The Application form was not ambiguous to the jury, which concluded from a layman's perspective that Home made misrepresentations about prior losses in the application process. (See Point III, below.)

Secondly, Home's argument implies that Standard Form 22 was the result of Aetna's unilateral drafting. To the contrary, Standard Form 22 is a product of arms' length negotiation between the Surety Association of America, an industry-wide collection of bonding carriers, and its counterpart, the U.S. League of Savings & Loan Associations, an industry-wide group of savings associations. See Affidavit of Frances X. LeMunyon at tab L of Aetna's Document Addendum. See also, Sharp, 858 F.2d at 1046. (The Sharp opinion is an excellent summary of the history and meaning of Standard Form 22.) As a result, the usual rule that ambiguity is construed against the drafter of a document is inappropriate in the context of Standard Form 22.

If anything, the language of the Bond has suffered only at the hands of Home's strained and unusual reading. The jury gave the language of the Bond and the Application their "usual and natural meaning" and found, to the extent allowed, in favor of Aetna. See LDS Hospital v. Capitol Life Insurance Co., 765 P.2d 857, 858-59 (Utah 1988). It was the trial court, at the considerable urging of Home Savings, which ignored the "existing circumstances [and] the purpose of the policy," id., and which, through interpretation and blatant interpolation reached the wrong conclusion. "Ambiguity must appear on the bond or policy and cannot be read into it by a

strained interpretation in order to permit recovery." 35

Am.Jur.2d, Fidelity Bonds and Insurance, § 3, p. 505 (1988).

The special rules of interpretation do indeed apply only when there is an ambiguity; courts ought not to strain to find such ambiguities, if, in so doing, they defeat probable intentions of the parties. This is so even when the result is an apparently harsh consequence to the insured.

Calcasieu-Marine National Bank v. American Employers' Insurance Co., 533 F.2d 290, 296 (5th Cir. 1976), cert. denied, 429 U.S. 922, 97 S. Ct. 319, 50 L.Ed. 2d 289 (1976).

POINT I

SECTION 11 OF THE BOND PRECLUDES COVERAGE FOR LOSS FROM LARRY GLAD'S CONDUCT BECAUSE HOME SAVINGS LEARNED OF HIS DISHONESTY SEVEN MONTHS BEFORE THE BOND WAS PURCHASED.

Introduction.

Section 11 of Standard Form 22 provides that fidelity coverage for a given employee terminates immediately and automatically as soon as the insured employer learns that an employee is dishonest. Courts have repeatedly found that provisions identical or similar to Section 11 are valid, unambiguous, and enforceable. E.g., Alfalpa Electric Cooperative, Inc. v. Travelers Indemnity Co., 376 F. Supp. 901, 912 (W.D. Okla. 1973); Ritchie Grocer Co. v. Aetna Casualty & Surety Co., 426 F.2d 499, 500 (8th Cir. 1970),

Verneco, Inc. v. Fidelity & Casualty Co., 219 So. 2d 508, 510 (La. 1969).

This well understood provision is based on solid public policy. A surety insures for the actuarial risk that an unknown member of the general population of employees may be dishonest thereby causing a loss. However, once an employer learns of dishonesty by a specific employee, the risk is no longer based on actuarial possibilities. When the employer knows of an employee's predisposition to dishonesty, neither the surety nor the employer should expect further coverage for that employee unless the parties contract for special re-inclusion of that employee in the bond. Therefore, although there may have been initial coverage for Larry Glad under the F&D policy, there was no coverage by F&D for losses caused by Glad's conduct which occurred subsequent to Home's discovery of his dishonesty. Nor was there renewed coverage for Larry Glad under the Aetna Bond for any of Larry Glad's conduct because his known dishonesty was not disclosed to Aetna.

A. The Correct Judicial Application of Section 11.

Section 11 of Aetna's Bond precluded coverage from ever going into effect as to Larry Glad. Aetna, as a new bonding company, did not "assume liability for losses resulting from acts committed before the inception of [the bond] by an employee who was never within the coverage of the [bond]."

C. Douglas Wilson & Co. v. Insurance Co. of North America, 590 F.2d 1275, 1279, n. 6. (4th Cir. 1979), cert. denied, 444 U.S. 831 (1979). As in Ritchie Grocer, supra., where the employee's dishonesty was discovered before he was hired, coverage under Aetna's policy never went into effect for Larry Glad.

The courts which have considered employee dishonesty discovered before the effective date of a new Bond have universally held that coverage never goes into effect for the known dishonest employee. In St. Joe Paper Co. v. Hartford Accident and Indemnity Co., 359 F.2d 579, 580 (5th Cir. 1966), the Bond provided for cancellation "immediately upon discovery by the Insured . . . of any fraudulent or dishonest act on the part of such Employee." As in the present case, "[P]rior to the inception of these policies, St. Joe Paper Company came into the possession of both information and knowledge that Jones had committed a dishonesty which, under the recited terms of the policies, barred recovery." Id. at 583.

Similarly, in Verneco, supra., the employee (Walden) was convicted of theft on November 2, 1960 and hired by the plaintiff companies with knowledge of that conviction in November 1961. Plaintiffs purchased a policy effective July 14, 1962 and discovered in December 1964 that Walden had been misappropriating funds and committing forgeries while in their employ. The court found that "no coverage ever obtained

insofar as Walden was concerned because the insured obtained knowledge of Walden's dishonest acts at least in November 1961 prior to the inception date of the policy in July 1962." 219 So. 2d at 510.

An identical result was reached in Fidelity & Casualty Co. v. Central Bank of Houston, 672 S.W.2d 641 (Tex. App. 1984), specifically in the context of a renewal bond. The court in that case held: "A renewal policy does not reinstate coverage for an employee that had already been terminated by a known dishonest act; it simply continues whatever coverage existed at the time of renewal." Id. at 647.

B. The Error in Home Savings' Analysis.

Home argues that Aetna's Bond covered Larry Glad because Section 11 voids coverage only for losses arising from actions subsequent to discovery of an employee's dishonesty ("subsequent losses"). This argument is only valid as to the F&D Bond, which was in place at the time the dishonesty and the likelihood of loss were discovered. Of course, F&D could not avoid losses incurred as a direct result of Glad's conduct which occurred before his dishonesty was discovered. However, F&D would not be responsible for losses caused by subsequent conduct if Home had elected to keep Larry Glad on the payroll after mid-December 1981. And Aetna, which only accepted an actuarial risk for the general employee

population, never accepted any risk for loss from Glad's misconduct.

Home also argues that because Glad's dishonesty prior to Home's learning of such dishonesty "permeated" or affected 34 of the 36 AFCO investor loans, coverage for the loss on those 34 loans was not terminated. This would be true if Aetna (instead of F&D) had provided coverage at the time of Home's discovery of Larry Glad's dishonesty. But it is not true where Aetna's coverage commenced more than seven months after the dishonesty was discovered and where Home already knew that losses on the AFCO investor loans would likely occur.

The issue of whether Section 11 precludes coverage under a newly issued bond for both "prior losses," as well as "subsequent losses," was addressed in the leading case of C. Douglas Wilson & Co. v. Insurance Co. of North America, 590 F.2d 1275 (4th Cir. 1979), cert. denied, 444 U.S. 831 (1979). The pertinent facts in Wilson & Co. v. INA are almost identical to those in the present case. Wilson was a mortgage subsidiary of a bank holding company. On March 16, 1973, Barksdale, then an employee and vice president of Wilson, was found to have falsely certified information on HUD forms regarding the dates and amounts of advances to loan customers. Wilson did not notify its fidelity bond insurer, St. Paul Fire & Marine, of Barksdale's actions. On March 25, 1973, INA and Hartford combined to issue new fidelity coverage for Wilson.

Hartford's and INA's contracts were "loss discovered" bonds, as was Aetna's herein.

Five weeks after the first discovery of Barksdale's dishonesty, Wilson learned that earlier he had also falsely certified receipt of letters of credit required by the FHA to insure loans. Losses resulted and Wilson asserted fidelity claims against INA and Hartford. Both insurers denied coverage because of Wilson's knowledge of Barksdale's unrelated dishonesty on March 16, 1973, before the INA and Hartford fidelity bonds became effective. The court concluded that under the operation of the termination clauses of their policies coverage for Barksdale never went into effect. Id. at 1278. (The INA termination clause was identical to the Aetna Section 11 clause. Id., at 1277 n. 3, 1278.)

Since we conclude that Barksdale's false certification of pre-advances constitutes dishonesty as a matter of law and that Wilson had knowledge of it before the inception of the INA and Hartford policies, and since Wilson concedes that it did not notify INA and Hartford of Barksdale's dishonesty, we sustain the conclusion of the district court that under the terms of their respective policies INA and Hartford cannot be held liable for Wilson's losses.

Id. at 1279. Just as the Wilson court found as a matter of law that Barksdale's actions constituted dishonesty, the jury in the case at bar found that Home knew of Larry Glad's dishonesty in mid-December, 1981. (Jury Answer to Special Interrogatory No. 8.)

Judge Hoffman in the Wilson dissent argued, as does Home in the present case, that the termination clause was effective only as to "subsequent losses" and was not effective as to "prior losses." Id. at 1290-91. However, the majority noted that this argument had validity only in the situation where the same insurer is at risk during the entire time at issue. So Home's argument would apply in this case only to F&D, but not to Aetna. The Wilson majority ruled that to hold INA and Hartford liable for loss from "acts committed before the inception of their respective policies by an employee who was never within the coverage of the policies [would be an] untenable result." Id. at 1279 n. 6. See also, St. Joe Paper Co. v. Hartford Acc. & Ind. Co., 359 F.2d 579, 583 (5th Cir. 1966) (employer's knowledge of employee's dishonesty acquired before bond went into effect prevented coverage from ever going into effect under a policy provision virtually identical to Section 11.)

In support of its position, Home reinterprets Fidelity & Casualty Co. of New York v. Central Bank of Houston, 672 S.W.2d 641 (Tex. App. 1984), which was cited by Aetna in its original brief in support of this Point I. Home claims that the court in F&C v. Central Bank "distinguished between dishonest acts occurring prior to discovery of dishonesty and those thereafter." (Home Savings' Brief at p. 54.) This is inaccurate, and it explains why Home finds the

case "confusing." The opinion in F&C v. Central Bank actually distinguished between losses occurring under a prior bond issued by the same company and those losses which occurred under the renewal bond in question. Id. at 650. Losses were distinguished prior to and after December 11, 1974, because that was the date the renewal bond was issued; contrary to Home's contention, that was not the date that Central Bank learned of employee De Lorenzo's dishonesty. Id. at 647, 650. In F&C v. Central Bank, the Texas Appellate Court correctly found that De Lorenzo was never within the coverage of the renewal bond, "because a renewal policy does not reinstate coverage for an employee that had already been terminated by a known dishonest act." Id.

Conclusion:

The same result should obtain here. The jury has established that Home Savings' management learned of Larry Glad's dishonesty seven months before management purchased the Aetna Bond. Although Home could have made a claim against F&D, it would be untenable to hold Aetna liable for losses attributable to Larry Glad, who had been terminated for his dishonesty seven months before Aetna ever issued its Bond.

POINT II

THERE IS NO COVERAGE UNDER THE BOND BECAUSE HOME SAVINGS DISCOVERED ITS LOSS OUTSIDE THE AETNA BOND PERIOD.

Introduction.

There is no coverage under Aetna's contract of insurance because Home Savings "discovered" its loss on the AFCO investor loans during the period of F&D's bond. Under a discovery bond, the timing of actual monetary damage is not relevant to the determination of coverage. Coverage is determined by discovery, which is when the insured learns of facts which have or may subject the insured to an indemnifiable loss. Tr. Ex. 343, Rider 6091. E.g., First Natl. Bank of Bowie v. Fidelity and Casualty Co. of New York, 634 F.2d 1000, 1004 (5th Cir. 1981). Accord: First Natl. Bank of Fleming v. Maryland Casualty Co., 581 P.2d 744, 745 (Colo. Ct. App. 1978).

A. Trial Court's Error.

The trial court misapplied the discovery standard by inventing the phrase "discovery of loss sustained." The bond contract contains no such language. The trial court's error is apparent on the face of its August 25, 1987 Order and Minute Entry:

For purposes of this motion, the court assumes the evidence establishes as a

matter of law that dishonesty of plaintiff's employee, Larry Glad, was known before the policy period commenced on June 21, 1982. This discovery of the dishonesty, however, is not discovery of a loss sustained. It is not the dishonesty which is insured, but the loss sustained thereby. There is no evidence that there was any loss sustained prior to the judgment in or settlement of the Armitage case. The Federal Home Loan Bank Board Report (Def. App. O), dated June 4, 1982, itself indicates that plaintiff Home Savings was subjected only to "possible losses." A loss cannot be discovered until sustained; since the latter occurred during the policy period, the discovery thereof could not have occurred earlier.

Order and Minute Entry at pp. 1-2, R. at 74-79.1 (emphasis added.)

Once the trial court equated loss with "damages" and found no damage until the period of Aetna's coverage, the outcome was predetermined and the substance of the bond -- what it covers -- was eviscerated. The Bond covers a loss "discovered" during the bond period. It does not cover "loss sustained" during the period of coverage. To the contrary, it expressly provides that the actual monetary damages can be "sustained at any time," and it presumes that damages probably will occur at a different time from discovery.

Discovery occurs when the insured becomes aware of facts which would cause a reasonable person to assume that a loss covered by the bond has been or will be incurred even though the exact amount or details of loss may not be then known. Notice to the insured of an actual or potential claim by a third party which

alleges that the insured is liable under circumstances, which, if true, would create a loss under this bond constitutes such discovery.

Rider 6091 (emphasis added).

The idea that "a loss cannot be discovered until sustained" is contrary to public policy and common sense. If that were the law, fidelity coverage for financial institutions could only be obtained by deception or by paying unconscionable premiums. Any time an insurer became aware of a potential loss from pending litigation which would not be resolved until after the renewal date, the surety would avoid coverage by simply refusing to renew the policy. The insured could then obtain coverage only by concealing the potential loss from a new carrier, or by paying the existing insurer a revised premium equal to the expected damages. Such a consequence thwarts the purpose of insurance and is contrary to public policy.

B. The Language of Standard Form 22.

Home seeks to circumvent the Bond's discovery standard by confining its operation to "notice" under Section 4. This is improper. The Bond's preamble is explicit with regard to the general applicability of the contract's Conditions and Limitations, of which Section 4 is a key provision. The preamble reads as follows:

The Underwriter, in consideration of an agreed premium, and subject to the

Declarations made a part hereof, the General Agreements, Conditions and Limitations and other terms of this Bond, agrees with the insured, in accordance with the Insuring Agreements hereof . . . with respect to loss sustained by the Insured at any time but discovered during the Bond Period, to indemnify and hold harmless the Insured.

(Emphasis added.) The Bond reiterates the incorporation and general applicability of all provisions at the top of page 4, which reads:

THE FOREGOING INSURING AGREEMENTS AND GENERAL AGREEMENTS ARE SUBJECT TO THE FOLLOWING CONDITIONS AND LIMITATIONS.

In addition, the title of Section 4 is "LOSS - NOTICE - PROOF - LEGAL PROCEEDINGS." Of course, Section 4 is augmented by the objective and per se definitions of discovery contained in Rider 6091. Thus, by its title, by its explicit terms, and by the Bond's internal references of applicability, discovery of employee dishonesty pertains to both procedural (i.e., notice) and substantive (i.e., coverage) aspects of the contract.

The cases are consistent with this policy language:

The discovery provision in question [the objective and per se definitions found in Rider 6091] is found in section four of the bond which is entitled "Conditions and Limitations." The definition of discovery clearly acts as a limitation on coverage, as the bond only applies to losses "discovered by the Insured during the bond period."

Home Life Insurance Co. v. Clay, 13 Kan. App. 2d 435, 773

P.2d 666, 677 (1989) (emphasis added). See also, Royal

Trust Bank v. National Union Fire Insurance Co., 788 F.2d 719 (11th Cir. 1986) (rejection of bank's argument that the Section 4 discovery definition applied only to notice, but not to determination of coverage.) The Bond only makes internal sense, and it only meshes logically and correctly with prior and subsequent fidelity policies, if discovery of loss is given the one established meaning which is addressed in the case law and defined in Rider 6091. See, e.g., Central Progressive Bank v. Fireman's Fund Ins. Co., 658 F.2d 377 (5th Cir. 1981).

Home's attempt to give the term two distinct meanings in the same document is an exercise in obfuscation.

Insurance policies, as other contracts, must be construed as a whole. The meaning of a contract should always be ascertained by a consideration of all the pertinent provisions and never be determined by critical analysis of a single or isolated provision.

Home Life Ins. Co. v. Clay, 13 Kan. App. 2d 435, 773 P.2d 666, 676 (1989) (citations omitted).

C. Timing of Insured's Actual Loss or Damages is not Relevant.

In its Brief, Home argues for nine and one-half pages (see Home's Point I at pp. 35-44) that it could not have discovered its loss prior to the period of Aetna's Bond because it had not "sustained" such a loss until the Armitage verdict was entered against it. No legal authority is cited in support

of this proposition. The cases are all to the contrary -- the timing of the actual monetary loss is not relevant to the issue of coverage under a "discovery" bond. E.g., First National Bank of Fleming v. Maryland Casualty, 581 P.2d at 745; FNB Bowie v. Fidelity and Casualty Co. of New York, 634 F.2d at 1004.

Home's policy argument on this point is a red herring. Home contends that if one standard for discovery of loss determines both notice and coverage, then in order for the insured to act properly, it would be required to simultaneously defend against charges of fraud in third party lawsuits while admitting employee fraud in its notice to its insurer. This is a makeweight argument. A third party complaint constitutes discovery per se under the Rider 6091 definition. FNB Bowie v. Fidelity and Casualty Co. of N.Y., 634 F.2d at 1004. Notice of such discovery need only entail a description or identification of the complaint, much as Home finally provided to Aetna in its December 1982 letter (Tr. Ex. 140). This would be a far different case if Home Savings, like the insured in FNB Bowie, had simply acted reasonably and prudently by providing F&D with letters and complaints as they were received in February, March, April, and May 1982.

D. Home Savings' Discovery of Loss as a Matter of Law.

Home finally argues that there was no undisputed determination by the trial court that Home actually discovered the loss -- as the term is correctly defined and applied -- prior to the Bond's period of coverage. This is simply not true. The trial court held: "For purposes of this motion, the court assumes the evidence establishes as a matter of law that the dishonesty of plaintiff's employee, Larry Glad, [which resulted in Home's loss] was known before the policy period commenced on June 21, 1982." At the time of the motion, Aetna had presented the trial court with a wealth of facts to establish that prior to June 21, 1982, Home Savings was aware of information that would lead any reasonable person to conclude that a loss was imminent.

Those facts fall into the following categories:

1. Home's knowledge in December 1981 of the \$15,000 kickback received by Larry Glad from AFCO for the handling of the AFCO investor loans.
2. Extensive information about the financial difficulties of the AFCO businesses.
3. Letters from Grant Affleck and attorneys for investors addressing irregularities and alleging fraud in the AFCO investor loans.
4. Three lawsuits (one of which was the predecessor of the Armitage v. Home Savings case) alleging fraud and extensive irregularities in the AFCO investor loans by Home Savings and its employees, Larry Glad and William Cox.

5. Federal Home Loan Bank Board ("FHLBB") examination reports highlighting irregularities in the AFCO investor loans and documenting existing losses.

(R. at 200-200.20.) The facts were substantiated by a 170 page Appendix containing 15 uncontested exhibits, most of which became trial exhibits. (Cf., Appendix, R. at 2928-3098, with Tr. Exs. 343, 13, 81, 111, 20, 356, 357, 358, 359, 360, and 190.) In its response to Aetna's Motion for Summary Judgment, Home Savings admitted (R. at 257), or simply did not respond to most of the facts. The only one of Aetna's twenty-three factual statements that Home contested was the timing of its receipt of a credit report on the AFCO businesses.

Five of the factual statements from Aetna's Summary Judgment Motion were incorporated into the Stipulated Pretrial Order's section of Uncontroverted Facts. These were paragraph 6: the existence and Home's knowledge of Glad's AFCO kickback; paragraph 9: knowledge of AFCO bankruptcy; and paragraph 11: the existence and knowledge of the Bott, Alcorn, and Clifford Complaints. All of the factual statements in support of Aetna's Motion for Summary Judgment were proven at trial. See Aetna's Appellate Brief at Statement of Facts, para. 2.a-n; pp. 9-14. Now, in its responsive Brief, Home contests only the date when it received the FHLBB Examination Report (Tr. Ex. 196), but not the content

nor the fact that the date on the Report predates the purchase of the Aetna Bond.

As shown, there was overwhelming evidence to conclude, as the trial court did, that "as a matter of law the dishonesty of plaintiff's employee, Larry Glad, was known before the policy period commenced on June 21, 1982." (R. at 344.) This evidence not only operated to terminate coverage for Larry Glad under Section 11 (see Point I, above), but also constituted discovery of loss by both the objective and per se standards of Rider 6091. The trial court's error was in limiting its evidentiary conclusion to the notice issue, instead of applying it also to the ultimate issue of coverage.

Conclusion.

Discovery of loss sufficient to activate the Section 4 notice requirement also determines whether coverage falls under an existing, prior, or subsequent bond. Under this state of the law, it is inconceivable that Home Savings can have coverage under Aetna's contract for damages resulting from the Armitage case, which was commenced in April 1982, during the period of F&D's coverage. In FNB Bowie, a single letter from an attorney for a third party was sufficient to establish per se discovery of loss. It made no difference that the allegations were then unproven or that the bank did not believe them.

The trial court was correct to conclude as a matter of law that Home had "discovered" Larry Glad's dishonesty (and its own loss) during the period of F&D's policy, not Aetna's. But the Court of Appeals should correct the trial court's misapplication of that finding by now entering judgment in favor of Aetna.

POINT III

THE JURY'S RESPONSES TO SPECIAL INTERROGATORIES 2 AND 4 REGARDING HOME'S MISREPRESENTATIONS IN THE APPLICATION PROCESS MANDATE A VOIDING OF THE BOND.

Introduction.

Home's response to this Point III confuses the alternative grounds on which Aetna prevailed on this issue at trial, before the trial court set aside the jury's findings on Special Interrogatories 2 and 4. A brief overview will help refocus the legal analysis and the marshalling of evidence.

The relevant statute, U.C.A. § 31-19-8(1) (1974), deals with affirmative or written insurance applications. It has three separate, independent standards for negation of coverage. (See discussion at Point III.B. of Aetna's initial brief, pp. 48-52.) The first statutory standard, involving "fraudulent" statements, is not involved here. U.C.A. § 31-19-8(1)(a). The second statutory standard, involving misstatements which are material to the insurer's acceptance of the risk or hazard, is an objective test of materiality. Id.

at § 8(1)(b). The third statutory standard, involving what a particular insurer would have done if it had known the true facts, is a subjective test in the nature of detrimental reliance. Id. at § 8(1)(c). These standards were stated in the disjunctive so that any one of them could negate coverage. Hardy v. Prudential Ins. Co., 763 P.2d 761, 766 (Utah 1988).

Special Interrogatory No. 2, as written by the court, combined in the conjunctive both the second and third statutory standards. In its answer to Special Interrogatory No. 2, the jury had to find both objective material misrepresentations on the Bond Application form (Tr. Ex. 122), as well as subjective, detrimental reliance by Aetna on those misstatements in order to answer the question as it did. Despite this unnecessarily high hurdle, the jury found misrepresentations under both standards. The trial court's failure to distinguish these separate, independent standards is apparent in its post-trial analysis of the subjective evidence (largely the Don Bradshaw and David Robinson testimony) to conclude that there was insufficient evidence for the jury to find that an objectively material misrepresentation had occurred.

Because the trial court's error was the starting point for this Point III analysis, in its original Brief Aetna reviewed primarily the sufficiency of the subjective evidence. (See Point III. A. at pp. 45-48.) However, the initial focus on evidence relating to the subjective statutory standard

should not obscure the significant, independent evidence of objective, material misrepresentations by Home. The evidence of those misrepresentations is reviewed in greater detail in this Point III at A, below.

Special Interrogatory No. 4 addressed an entirely separate common law duty to disclose material information, even if it is not asked for in the application process. This duty arises, in part, from the special nature of coverage. The common law duty to disclose is also based on an implied covenant of good faith and fair dealing which exists in all contracts. Beck v. Farmers Ins. Exchange, 701 P.2d 795, 798 (Utah 1985). Because an insured cannot improve its coverage of existing circumstances by simply changing policies or insurers, it has a duty to disclose to a new insurer all facts which are material to coverage under an existing Bond. Analysis under the common law standard is similar to the concept of unilateral mistake of fact in standard contract formation law where a contract is void if the non-disclosing party knows or has reason to know that the mistaken party would consider the fact material, if it were disclosed. Kiahtipes v. Mills, 649 P.2d 9, 13 (Utah 1982).

Of course, Aetna prevailed on the common law standard as well. The trial court's decision to disregard the jury's answer on Special Interrogatory No. 4 was based on a legal conclusion that no duty existed to disclose information outside

the written application process. This ruling ignores the current law which recognizes the continuing importance and vitality of common law contract principles in the context of insurance policy formation.

A. Home's Material Misrepresentations on the Bond Application: U.C.A. § 31-19-8(1)(b).

Contrary to Home's contention, the material facts which Home misrepresented in the Application really came into evidence throughout the whole course of trial. For instance, Question 17 of the Application (Tr. Ex. 122) inquired:

List on page 4 all losses sustained by date, type and amount, whether reimbursed or not, during the last six years. If none, so state:

Home responded: "None over deductible amount [\$5,000]." On page 4 of the Application, where Home should have listed information pertaining to losses on the AFCO investor loans under the heading, "Amount of loss pending," Home made no entry.

Home Savings also indicated in response to Question 13(c), that the date of its last examination by state or federal regulatory agencies was "June 1982." In that very Report for "Examination as of June 4, 1982," (Tr. Ex. 196), the FHLBB noted that Home Savings was already booking losses pertaining to the AFCO investor loans. Under the heading,

"Affect on Operations," the examiners stated that "management had established an \$85,000 reserve for uncollected interest on the loans The operating loss through May 31 was \$67,402" (Id. at 2.2) (emphasis added). The examiners also wrote that "None of the borrowers are making payments, the loans are scheduled items [read: high risk of loss] and the institution has commenced foreclosure." (Tr. Ex. 196 at 2.) The examiners further noted the existing lawsuits by AFCO investors against Home Savings, the nature of the claims made in those lawsuits, and that rescission of the AFCO investor loans was a remedy sought. In summary, the FHLBB said that "by deviating from normal loan processing procedures, management has subjected the institution to high scheduled items ratios, lawsuits and possible losses." (Id. at p 2.1.) At trial, the jury also heard direct evidence of Home's knowledge of the AFCO investor lawsuits and attorney letters.

In addition to the foregoing omissions and misrepresentations, Question 15(c) of the Application asked:

Is there a formal, planned program
requiring segregation of duties so that no
single transaction can be fully controlled
(from origination to posting) by one person?

Home Savings answered "yes" to this question. However, Home Savings contended throughout trial that its losses resulted from Larry Glad having control over multiple facets of the subject loans, from origination to closing. (See, e.g.,

Statement of Facts in Home's responsive Brief, paras. 30, 42, 43, 46-52.)

A misrepresentation is material "if reasonable insurers would regard the fact as one which substantially increases the chance that the risk insured against will happen and therefore would reject the application." Hardy v. Prudential Ins. Co., supra, 763 P.2d 769, 770 (Utah 1988). The magnitude of the evidence, Home maintains that it answered the Application correctly and without omissions. The jury concluded to the contrary. The trial court distorted its analysis in deciding to reject the jury's finding, considering only the subjective issue of what Aetna would have done if it had known the true information, but ignoring the jury's separate finding of objective materiality. Home has therefore failed to meet its burden to prove insufficient evidence in order to have the trial court's rejection of the jury finding sustained on appeal. State v. Tolman, 775 P.2d 422, 424 (Utah Ct. App. 1989).

B. Aetna's Subjective Reliance on Home's Application Form Misrepresentations on the Application (U.C.A. §§ 31-19 - 8(1)(c)).

In addition to the wealth of objective evidence presented to the jury, Aetna also offered testimony from the bond agent, Don Bradshaw, and from Aetna's bond underwriter, David Robinson, as to the effect of such misrepresentations on

Aetna's willingness to enter into a contract in light of such risks. (See Appellant's Brief, Point III, at 46-48.) Such direct testimony was not necessary to support a jury finding on this point, because the jury could have drawn the inference from the seriousness of the misrepresentations that no surety would have written a bond for such risks under those circumstances. Nevertheless, the court permitted the testimony and the jury used it to support their finding. The trial court then improperly set aside this jury finding, because it later decided the supporting testimony was improper. The jury's determination should be reinstated and judgment in Aetna's favor entered accordingly.

C. Home Had a Duty to Volunteer Information Material to the Risk Insured.

A common law duty of voluntary disclosure was recognized by the United States Supreme Court in Stipcich v. Metropolitan Life Insurance Co., 277 U.S. 311, 316 (1928).

Insurance policies are traditionally contracts uberrimae fidei and a failure by the insured to disclose conditions affecting the risk, of which he is aware, makes the contract voidable at the insurer's option.

Concededly the modern practice of requiring the applicant for life insurance to answer questions prepared by the insurer has relaxed this rule to some extent, since information not asked for is presumably deemed immaterial.

(Citations omitted, emphasis added.) The Stipcich rule was applied more recently in Collins v. Pioneer Title Ins. Co., 629 F.2d 429 (6th Cir. 1980). The Sixth Circuit there held that the insured's duty to make a fair disclosure of the facts means that it must disclose information which is material to the risk involved. Id. at 434 (cites omitted). "Whether information not disclosed is material is a question of law for the court." Id. (Citations omitted.)

As shown in Point III.C. of Appellant's Brief (pp. 52-54), Home Savings clearly failed to disclose such material facts about the AFCO investor loan problems and Larry Glad's involvement in them. The jury determined unequivocally in its answer to Special Interrogatory No. 4 that the information was both material and omitted. The common law standard should be recognized and upheld, and the jury's determination should be implemented through a reversal in Aetna's favor.

D. The Issue Was Properly Preserved for Trial and is Ripe for Appellate Review.

In an effort to circumvent the effect of its misrepresentations in the Bond application process, Home contends that the misrepresentation issues were only raised late in the trial. This is not true. Aetna first addressed these issues in the 12th and 13th defenses of its Answer. (R.

at 31-32.) Although there was some discussion at one point about waiving those defenses, the defenses were promptly reinstated and were made part of the Pretrial Order (R. at 738) where they were addressed in four different places. In addition to the court's specific order that they could be reasserted (id.), Aetna listed misrepresentation as one of its claims in this case (R. at 722), misrepresentation as a question of fact for the jury (R. at 730), and the duty to volunteer information in the application as a question of law (R. at 732).

Not only was this issue discussed in pretrial motions, but it was also discussed at great length when Don Bradshaw, the bond agent, first testified at trial on November 6, 1987. During cross-examination, Aetna's counsel attempted to inquire about the Application form. (Tr. Ex. 122.) The trial court took a proffer of evidence outside the hearing of the jury because it viewed the application issue as a question of law. (R. 2906.41.) In its proffer, Aetna examined Mr. Bradshaw about the Application form and specifically about Question No. 17. (R. 2906.41-51.) During part of that examination, a quotation from Mr. Bradshaw's deposition was published, in which he stated:

If a prospective client has any knowledge of a loss, he should disclose it in that application whether it is a possible loss or a factual loss.

(R. 2906.46.) The trial court refused Aetna's request to ask Mr. Bradshaw, in the hearing of the jury, if the Application called for any loss information generally. (R. 2906.50.) However, further evidence regarding the Application form was elicited from both Mr. Bradshaw and from Aetna's representative, David Robinson, later in the case. (R. at 2916.11, .20-23, .51-52.) The jury heard that testimony and made a common sense determination of what should have been disclosed in the Application.

Based on the trial evidence, the jury concluded that Home Savings' responses constituted material misrepresentations and that those misrepresentations were subjectively critical to Aetna's decision to issue the Bond. Furthermore, the jury concluded that, given the nature and form of the inquiries in the application process, Home Savings should have volunteered pertinent information about potential losses to Aetna. The issues were tried on the evidence and decided by the jury. The result should be sustained in Aetna's favor over the machinations of Home Savings and the mistakes of the trial court.

E. Aetna May Rescind Coverage with Respect to Larry Glad Only or it May Rescind the Entire Bond.

In Special Jury Interrogatory No. 2, the jury decided that if Aetna had known the facts misrepresented or not

disclosed by Home, "it would not have issued the bond or would have excluded the risk disclosed." Home never disclosed risks related to the dishonesty of Larry Glad. Therefore, the bond was void ab initio with respect to Larry Glad, because "the provision in each bond relating to discovery of employee dishonesty does not cause a forfeiture of the entire bond [R]ather, this provision simply provides that the blanket coverage of the bond does not extend to employees of the insured who are known by the insured to be dishonest." C. Douglas Wilson & Co. v. Insurance Co. of N.Am., 464 F. Supp. 1, 17 (D.S.C. 1977), aff'd., 590 F.2d 1275 (4th Cir. 1979), cert. denied 444 U.S. 831 1929.

As stated in the Introduction, Aetna contracted to provide fidelity coverage to Home only as to the generic employee population. Therefore, Aetna may rescind coverage for the risk it would have excluded had it been informed of Larry Glad's specific dishonesty; and it can do so without a refund because no premium was ever received for that risk. Since "there was never any coverage as to [Larry Glad], there was never anything which could be forfeited." Id.

Aetna may also rescind the entire bond because of misrepresentation and non-disclosure. The general rule is that a "return of the premium is not essential to the avoidance of a policy, nor is its retention a waiver, especially . . . where knowledge of the ground of avoidance is first obtained

after a loss." 44 Am. Jur. 2d § 1646. The several cases cited by Home in support of its theory that Aetna has waived its right to rescind the policy are inapposite because in every instance the insurer performed some affirmative act which ratified the existence of the policy after having discovered grounds for rescission. For instance, in Dairyland Ins. Co. v. Kammerer, 327 N.W.2d 618, 619 (Neb. 1982), the insurer was deemed to have ratified the policy by giving notice of cancellation of the coverage on a date after its discovery of grounds for rescission, and by retaining the premium through the date of cancellation. In Perry v. Woodall, 438 P.2d 813, 814 (Utah 1968), a purchaser of a business attempted to renegotiate the purchase price while continuing to operate the business after he had discovered grounds for rescinding the contract. In that case, the court held that he waited too long to attempt to rescind. Id. at 815. In Verex Assurance, Inc. v. J. Hanson Sav. & Loan, 816 F. 2d 1296 (9th Cir. 1987,) the insurer was deemed to have waived its right to rescind because it accepted premiums after receiving notice of a reason to rescind. See also, Farrington v. Granite State Fire Ins. Co. of Portsmouth, 232 P.2d 754 (Utah 1951). By contrast, in this case no act of Aetna was inconsistent with rescission of coverage for losses from the AFCO investor loans, and so coverage should not be created by an imputed waiver.

The doctrine of reliance also validates rescission without immediate refund of premium. An excellent example is Robertson v. Farm Bureau Mutual Ins. Co. of Arkansas, Inc., 668 F. Supp. 1259, 1261 (W.D. Ark. 1987), where the court held that the insured could not invoke the doctrine of estoppel against an insurer in the absence of any proof that the insured changed his position for the worse in reliance on the insurer's failure to refund a premium. Similarly, in Di Santo v. Enstrom Helicopter Corp., 489 F.Supp. 1352, 1360 (E.D. Pa. 1980), the insurer was not estopped from denying coverage on the ground of failure to return the unearned portion of the premiums until three and one-half years after accident.

Home has not introduced any facts to show that Aetna ratified the Bond after discovering grounds for rescission either by collecting further premiums or by attempting to cancel the Bond. Nor can Home show that it relied on Aetna's coverage to its detriment, especially where it failed to disclose material facts and could have made a claim for coverage under the existing F&D bond when it became aware of those facts.

POINT IV

THE TRADING EXCLUSION VOIDS
COVERAGE UNDER THE BOND FOR LOSSES ON
THE AFCO INVESTOR LOANS.

Introduction.

Home Savings agrees with Aetna that the purpose of the Bond's trading exclusion (Rider 6030a) is to omit from coverage the type of risk associated with securities transactions. (Home Savings' Brief at p. 79.) Therefore, the question for appeal is whether the losses in this case arose out of trading in securities and whether that issue has been properly preserved for review by the Court of Appeals.

A. Trial Court Made Improper Legal Interpretation and Application of Rider 6030a.

Aetna's appeal on this issue is from the trial court's ruling in denying Aetna's Motion for Summary Judgment on the trading exclusion. The trial court did not give the trading exclusion rider its full, intended operation in light of the Armitage judgment. Home Savings calls the trial court's decision at summary judgment an "analytical opinion." But a careful reading proves exactly the opposite. Without legal support or policy analysis, the trial court essentially stated the same tautology repeatedly:

The nature of the evidence, jury instructions, and verdict in Armitage necessarily requires the nomenclature "involved in the sale or exchange of

securities" to characterize Home's conduct and the jury's findings. Such "involvement," however, does not necessarily equate to "trading" in securities as that term is used in Rider SR6030a.

Facilitation of a sale may constitute a sale under various securities statutes, but it does not necessarily constitute trading in securities as that term is used in Rider 6030a.

[A]n inherent finding of the prescribed acts "in connection with the purchase or sale of any security" . . . is not necessarily the equivalent of the finding that Home traded securities.

(R. at 329-330.)

The trial court erred in this ruling. Securities coverage was expressly culled out of Standard Form No. 22 because of the special risks inherent in that type of activity. Shearson/American Express v. First Continental Bank & Trust Co., 579 F.Supp. 1305 (W.D. Mo. 1984). That being the case, it was not the intention of the parties or the purpose of the Bond to cover losses resulting from a jury verdict of direct and secondary liability for securities law violations.

As Home Savings acknowledges, the relevant securities in the Armitage case were the promissory notes and trust deeds between AFCO and its investors. (See Armitage Jury Instruction No. 5.03, R. at 210.48.) It was in the context of trading in these securities that Home Savings was held liable in the Armitage case. Home was not held liable because it

was a lender to the AFCO investors, but because of its direct involvement with and support of Grant Affleck in the sale of the AFCO securities.

Contrary to Home's argument, the AFCO investor lending activity was unprecedented. Home Savings had only done 5 or 10 second mortgage loans for insiders prior to the AFCO investor loans commencing in November 1981. (William H. Cox Testimony, R. at 2914.96, 2905.34-.35.) In addition, Home had never used an outside loan broker such as Grant Affleck to solicit loans and process loan applications in the volume and with the pre-qualification commitments involved in this case. Fred Smolka testimony at R. at 2917.154, .160-.161, .179.) Trial Exhibits 8, 9, 10, 11, 89, and 90 document the negotiations of Home's management and its agreements with Affleck. In the Armitage lawsuit, Home was held liable for aiding and abetting Grant Affleck, not Larry Glad, and for controlling Affleck in the context of security violations.

Under these circumstances, there is no justification for the restrictive application which the trial court gave to the trading exclusion. The proper approach is demonstrated in Sutro Bros. & Co. v. Indemnity Insurance Co. of North America, 264 F.Supp. 273 (S.D. N.Y. 1967). In that case, coverage for a securities broker was denied under a trading exclusion when the broker's agent accepted uncertified funds in exchange for delivery of securities. The Federal District

Court there held that the loss was necessarily sustained directly or indirectly from trading and was therefore not covered by the fidelity provisions of the bond. Id. at 289. Coverage was excluded even though the loss was immediately caused by a bad check [here, rescinded second mortgage loans to the AFCO investors], because the loss occurred in the context of securities trading.

B. The Issue was Properly Presented to the Trial Court and Preserved for Appeal.

In response to Aetna's Motion for Summary Judgment, the trial court ruled as a matter of law that none of Home's various securities violations "necessarily equate to 'trading' in securities as that term is used in Rider SR6030a." (R. at 329.) The trial court's Minute Entry was not a "final judgment" subject to immediate appeal. Rule 54(b), Utah Rule of Civil Procedure. Nevertheless, the decision became the law of the case for purposes of trial, and it is now appealable.

Even after summary judgment, the issue of the trading exclusion was addressed, to a limited extent, in the actual trial. (See: "Defendant's Claims" and "Contested Issues of Fact" in the Stipulated Pretrial Order, R. at 722 and 730; Tr. Exs. 113-115, 196, 330, 356, and 357-360; Aetna's closing arguments, R. at 2917.180 - .226; and Aetna's Memorandum of Points and Authorities in Support of Judgment Notwithstanding the Verdict, R. at 1364-1368.) However, Aetna did not attempt

to present the issue directly to the jury because the trial court's ruling had eviscerated any factual issue. After having raised the issue in summary judgment and receiving an adverse legal ruling, it was not necessary for Aetna to browbeat the court with constant repetition of its claims. The trial court was aware throughout the proceedings that Aetna vehemently disagreed with several of its rulings on summary judgment issues (see, e.g., R. at 2923.224-.226.). A party does not lose appellate rights on such fundamental matters by refusing to be obstreperous at the trial level.

Conclusion.

Home Savings' argument that the loan to AFCO investors was its usual and ordinary course of business, and therefore not trading in securities, is intriguing in light of this unique chapter in Utah's history. The nature and reach of the AFCO scheme throughout the Utah financial community was unparalleled. Criminal and civil convictions for security law violations in a series of uniform loan transactions by a number of different lenders made to borrowers who were brought in bulk to lending institutions by an outside broker is without precedent. It is exactly this unique and novel type of risk for which the trading exclusion, Rider 6030a, was designed. The Court of Appeals should make a proper legal interpretation

of that key part of the contract of insurance and reverse the trial court's summary judgment ruling.

POINT V

**THE COURT ERRED IN REFUSING TO ALLOW THE JURY
TO CONSIDER HOME'S BAD BUSINESS JUDGMENT AND
MISMANAGEMENT AS CAUSES OF THE AFCO INVESTOR LOSSES.**

Introduction.

The Aetna Bond contained a causation requirement imposing liability on Aetna only for "loss resulting directly from one or more dishonest or fraudulent acts of an Employee." Tr. Ex. 343, Rider 6041. However, the jury made a finding of causation in Home's favor only because the combination of jury instructions and the Special Verdict form prevented consideration of whether the conduct of Home Savings' management constituted a separate and superseding cause of its loss. The record is filled with evidence that Home's officers and directors initiated and were actively involved in the AFCO loan program. (See, e.g., testimony of William H. Cox at Tab O of Aetna's Document Appendix.) However, the trial court refused to allow the jury to consider whether management's conduct constituted an alternate or superseding cause of the losses.

A. Home's Losses Were Caused by its Own Management Decisions.

The Armitage v. Home Savings case focused on Home's primary and secondary liability for fraud in the sale or exchange of AFCO securities. The Armitage case was not the only suit involving AFCO investors; sixteen other financial institutions (none of which employed Larry Glad) also made such loans and experienced similar results. Home's line of credit to AFCO and its authorization to make up to \$3 million in second mortgage loans to AFCO investors were both approved by Home's management and the Board of Directors, independent of Larry Glad. After Larry Glad was terminated, Home continued to process and complete loans to AFCO investors. Although it was alleged that Glad falsified information which resulted in loans to unqualified borrowers, the Armitage court imposed liability on Home because the nature of the transactions mandated a rescission of the loans. Home, like many of Utah's other lending institutions, would have suffered a loss on the AFCO investor loans even if Larry Glad were found to have been completely honest. Therefore, management's conduct was the one effective cause, and the superseding cause of the losses.

The trial court denied Aetna the opportunity to have the jury consider any cause for Home's losses other than the conduct of Larry Glad. Under the rule that the law will not permit one to profit from his own wrong, an insured under a

fidelity bond cannot recover if he has "knowledge of, or has countenanced, has acquiesced in or participated in the wrongful acts of his employees." Home Indemnity Co. v. Reynolds & Co., 187 N.E.2d 274, 283 (Ill. App. 1963) (citation omitted). If a corporation itself is "party to the acts complained of, there can be no recovery A policy of fidelity insurance does not insure an employer against his own fraud." Levey v. Jamison, 82 F.2d 958, 960 (4th Cir. 1936) (citations omitted). The jury, in its common wisdom, knew what was right: "the participation of high level officers of the Bank in a course of action determined at a high level to be in the best interests of the Bank prevents the Bank from obtaining indemnity . . . under the 'Fidelity' provisions of the bond." State Street Bank v. U.S.F.&G., 539 N.E.2d 779, 781 (Ill. App. 4 Dist. 1989). Aetna tried to have the jury decide whether the direct participation of Home's management in the AFCO investor loans constituted a separate and superseding cause of the loss. However, even though the trial court allowed the jury to hear a great deal of evidence regarding management's misconduct, it prevented the jury from considering management's role in the fiasco.

B. Aetna Properly Preserved the Jury Instruction and Special Verdict for Review on Appeal.

The required specificity in objection to a jury instruction is whether the trial court understands the nature of the objection and can make timely corrections. Employer's Mut. Liab. Ins. Co. of Wisconsin v. Allen Oil Co., 258 P.2d 445, 450 (Utah 1953). If an objection is made in conference, there is no requirement that it be exhaustively repeated in open court in order to preserve it for appellate review. Watters v. Query, 626 P.2d 455, 459 (Utah 1981) (compliance with Rule 51 where court was aware of objection to absence of jury instructions as a result of conference with counsel); Pagan v. Thrift City, Inc., 460 P.2d 832, 833-34 (Utah 1969) (trial court conference with counsel to discuss jury instructions found to be appropriate time to object.)

At this late date, the suggestion by Home's counsel that the trial court was not put on adequate notice of Aetna's objections is disingenuous. Home's counsel was present during numerous and lengthy conferences with the trial judge regarding jury instructions, Special Verdict form, and the Special Interrogatories. In fact, so much time was devoted to these conferences that they were held on the Saturday before the case was presented to the jury and on evenings following court sessions, after the court staff and court reporter had gone home. (R. at 2917.58.) Before the instructions were

presented to the jury, the court instructed counsel off the record that it was only necessary to state the subject matter of the objectionable instructions, rather than the specific numbers, because the reasons for the objections had already been discussed during the previous conferences and the court was in a hurry to submit the case to the jury. R. at 2917.59.

1. Proposed Jury Instructions No. 2 and No. 42.

With regard to Instruction Nos. 2 and 42, Aetna's counsel tried briefly to state reasons for objections, despite the court's instructions, in order to create at least a basic record of the basis for such objections. When Aetna's objection to the failure to give proposed Instruction No. 2 is considered in light of the text of that instruction (mismanagement as a sole and proximate cause of loss), there is no question as to Aetna's concern. The failure to give the instruction left the jury with no affirmative way to rule in Aetna's favor on its primary factual defense.

Aetna's objection on the court's failure to give proposed Instruction No. 42 was likewise adequate. That instruction, and the concept of officers and directors being a contributing cause of Home's losses, was a repeated and major topic of both the evidence and the in camera conferences. When the objection was made on the record, the trial court's awareness of its substance was demonstrated by its asking only

for clarification of Aetna's burden of proof on that issue.
(R. at 2917.63 l. 23-25.)

2. Objectionable Jury Instructions Nos. 26-30.

Under Rule 51, it is the duty of the trial court to cover the theories of both parties in its instructions. To determine if this is accomplished, the instructions must be considered as a whole. Startin v. Madsen, 237 P.2d 834, 836 (Utah 1951). Except for Instruction No. 29, which was not individually objectionable, Jury Instructions Nos. 26 through 30, when taken as a whole, misled the jury. Because of those instructions, the jury concluded that it was entirely precluded from considering whether management's involvement in the AFCO investor loans was a cause of Home Savings' losses. This explains the jury's frustration. After hearing weeks' of testimony about mismanagement, the trial court gave the jury no way to use such information. The cumulative effect of Jury Instructions Nos. 26 through 30 is reviewable under Rule 51, Utah Rules of Civil Procedure, which allows the court to exercise review at its discretion and in the interests of justice.

3. Special Verdict Form.

The rule is that "if . . . the court omits any issue of fact raised by the pleadings or by the evidence, each party waives his right to a trial by jury of the issue so omitted unless before the jury retires he demands its

submission to the jury." Utah Rule of Civil Procedure 49.

Aetna submitted a proposed Special Verdict form which contained the following Question No. 6:

Did any loss sustained by Home Savings directly result from the mismanagement, misconduct, and/or failure to follow safe and sound lending practices?

(R. at 1219.) It is true that Aetna's counsel prepared the final Special Verdict form in order to relieve typing demands on the court staff, but it did so with instruction from the trial court as to the final form the Verdict would take. By accommodating the court's need for additional typing resources, Aetna certainly did not waive its prior Rule 49 demand that Question No. 6 be presented to the jury.

4. Review of Error by Court of Appeals.

Even if the objections stated in the record are found to be deficient, this court, "in its discretion and in the interests of justice, may review the giving or failure to give an instruction." Utah Rules of Civil Procedure, Rule 51. Where Aetna presented substantial evidence in support of its theory of causation, it was entitled to have the issue submitted to the jury. The circumstances limiting the opportunity to make a more complete statement of the nature of its objections, and the fact that the instructions taken as whole prevented the jury from addressing the issue, dictate that Aetna be granted a new trial.

C. Aetna Was Prejudiced by the Special Verdict Form and the Jury Instructions as Given.

Aetna was prejudiced by the combination of omitted instructions (proposed Nos. 2 and 42), the effect of the instructions actually given (Nos. 22, 23, 24, 25, and 26), and the truncated Special Verdict without Aetna's proposed question No. 6. The primary way to demonstrate that prejudice is to show what the jury would have decided had it understood and been presented the opportunity to do so. For that purpose, the juror affidavits were obtained. R. at 2032-53, 2055-57. (Copies of the juror affidavits are included at Tab J of Aetna's Document Addendum.) The jury in this case bemoaned the fact the case had been "taken away from it" by the instructions and limited verdict.

Of course, prejudice can also be determined by independent analysis of the reviewing court. Even without the jurors' direct comments, it is evident that Aetna's causation theories were omitted from the jury's consideration. Where a defendant's primary factual defense is presented to the finder of fact only as the unspoken negative of the plaintiff's case, the prejudice is patent. The case should be remanded for a fair determination based upon an equal explanation of the competing theories of the case.

POINT VI

WITHOUT F&D MARYLAND AS A PARTY,
COMPLETE RELIEF WAS NOT AVAILABLE TO AETNA.

F&D was a necessary party to the action because "in [its] absence, complete relief cannot be accorded among those already parties." Rule 19, U.R.Civ.P. A primary issue throughout the case was coverage based upon discovery under the Standard Form 22's objective and per se standards. (Rider 6091.) Specifically, Aetna contracted with Home to cover only losses discovered within the period of its coverage. Standard Form 22 specifically excludes coverage for losses discovered under prior or subsequent policies. To the extent the loss in this case was caused by employee infidelity (Rider 6041), coverage was only available under F&D's prior bond because it was the contract in place when Home made its discovery.

The trial court was unable to read Aetna's policy correctly in the absence of F&D as a party. For instance, on the Section 11 issue, the trial concluded before trial that Aetna's position would enable an insurer to collect premiums for providing no coverage. This conclusion ignored the circumstances of the case. There was coverage, to the extent there was a valid fidelity claim. But it was F&D which collected premiums from Home in exchange for that coverage.

The trial court also became tangled up in Home's Section 11 argument of "prior" and "subsequent" losses. That distinction was only relevant to coverage under F&D's policy. See, Point I, above; C. Douglas Wilson & Co. v. Insurance Co. of North America, 464 F. Supp. 1, 17 (D.S.C. 1977), aff'd., 590 F.2d 1275 (4th Cir. 1979), cert. denied, 444 U.S. 831. But the trial court lost sight of the correct analysis because of F&D's absence from the case.

The prejudice to Aetna from F&D's absence is apparent in the trial court's skewed analysis. The issue at trial should not have been whether there was or was not coverage under the Aetna Bond. The proper analysis should have been whether coverage was barred by both bonds because of management's participation (Point V) or the trading exclusion (Point IV), and if not, which of the losses were covered by F&D's policy. The obvious prejudice is grounds for reversal.

POINT VII

A JUDGMENT MUST ACCURATELY REFLECT THE ACTUAL DAMAGES PROVEN AT TRIAL.

Home Savings does not contest the \$237,760.77 of actual monetary benefit it received from proceeds of the 36 AFCO investor loans. Instead, Home argues that the issue was a jury question, and that by failing to explicitly reserve the issue Aetna waived its right to have the trial court include the setoff in calculation of the judgment.

This position is directly contrary to the one Home took in the trial court. There, it agreed that the calculation of damages was a matter reserved to the trial court.

By stipulation of counsel, the jury was not asked to identify a loss amount attributable to each loan, nor to add losses in order to calculate damages.

(Plaintiff's Memorandum in Support of Proposed Judgment, R. at 180.3.) The fact of this agreement is demonstrated by the complete absence in the Stipulated Pretrial Order of any amount of damages or any affirmative submission of damages to the jury as a disputed issue of fact. The reservation of damages is also supported by the form of the Special Verdict, which makes no mention of the amount of the AFCO investor loans. Presumably, Home would not be satisfied with a judgment based solely on the jury's determinations, as they include no measure of actual monetary damages.

The truth of the matter is that the parties reserved a number of issues in this very complicated case for determination after trial. This was consistent with Home's prior course of conduct in the Armitage case. In Armitage, as here, the jury was simply asked to enter a special verdict on liability. (R. at 1347-1350; copy at Tab C of Aetna's Document Addendum.) The calculation of damages was reserved for the trial court, which ironed out the complicated issues of

accounting, including proper setoffs, after trial. (See Armitage Judgment on Special Verdict, Tr. Ex. 330.)

There being no issue as to the amount of Home Savings' benefit from the AFCO investor loan as reflected in Trial Exhibit 83, the question for appeal is whether the trial court entered a judgment which is fair and accurate on the basis of the evidence. The answer is "no." The proper approach to this type of situation is demonstrated in Everhart v. Drake Management, Inc., 627 F.2d 686 (5th Cir. 1980). In that case, the court held that a fidelity bond did not cover shortfalls in one account when the insured made a business decision to apply limited funds to other accounts.

[The insured] suffered no increase in liability as a result of the permanent investment funds being deposited to a general company account. [The insured] merely experienced a shifting of liabilities for which it was not entitled to recover against the Insurer. Fidelity & Deposit Co. v. Usaform Hail Pool, Inc., 463 F.2d 4, 5 (5th Cir. 1972).

Id. at 691.

In the present case, Home Savings consciously took almost a quarter of a million dollars of revenue from the AFCO investor loans and allocated it to its other business purposes. (Tr. Ex. 83.) As previously shown, the purpose of the Bond is not to cover losses which naturally arise from management decisions and the ups and downs of ordinary business. An insured should not be allowed to increase a

covered loss by its choices of revenue allocation. If the Court of Appeals does not reverse the trial court's judgment on the basis of the foregoing points, it should remand with instructions to reduce the judgment by \$237,760.77, which was Home Savings' profit from the AFCO investor loans as reflected in Home's own Trial Exhibit No. 83.

POINT VIII

HOME SAVINGS IS NOT ENTITLED TO INDEMNIFICATION
FOR THE LEGAL FEES AWARDED TO THE ARMITAGE PLAINTIFFS
NOR THE ENTIRE AMOUNT OF COURT COSTS AND ATTORNEYS'
FEES INCURRED IN DEFENDING THE ARMITAGE LITIGATION.

A. Home Savings is not Entitled to Indemnification of Legal
Fees Awarded to the Armitage Plaintiffs.

Home cannot recover the amount it paid the Armitage plaintiffs' for legal fees (\$190,647.31), because those fees derived from claims which are expressly excluded from bond coverage. Fees were awarded under the Utah Securities law, Utah Code Ann. § 61-1-22(1)(b) and violation of the truth-in-lending laws (see 15 U.S.C.A. §1640(a)(3); and Utah Code Ann. § 70b-5-203(1)(c)). Of course, violations of securities laws are excluded by the Bond's trading exclusion. (See Point IV, above.) And the losses from violations of truth-in-lending laws were caused by Home's officers, Bill Cox and Elaine Reese.

The evidence shows that Elaine Reese, a corporate officer of Home (R. at 2903.116, ll. 9-12) who was responsible

for preparing the loan closing documents (R. at 2093.121 l. 8), initially backdated loan documents at the direction of her immediate superior, Bill Cox (R. at 2903.112, ll. 2-12). Subsequent violations, even if influenced by Larry Glad, were caused by Elaine Reese because Larry Glad had no authority to instruct her to backdate loan documents and she did not work for him. (R. at 2903.151, ll. 20-25.) She also failed to get approval from her supervisor, Bill Cox, for any backdating of documents after the first loan. (R. at 2903.113, ll. 10-12; 2903.112, ll. 16-17.) Prior to trial, Home specifically elected to limit its claim to only those losses caused by Larry Glad. (Stipulated Pretrial Order, R. at 719-731.) And the jury was instructed that only losses caused by Larry Glad would be covered. (Jury Instruction No. 22.) Therefore, even if losses from the truth-in-lending violations were covered by the Bond, Home's claim does not reach them.

B. Home Savings May Not be Awarded Legal Fees Incurred in Defending the Armitage Litigation for Losses That are Not Covered by the Bond.

The purpose of Aetna's stipulating to the reasonableness of \$437,500 for Home's Armitage defense costs was to establish actual amounts, while preserving the issue of ultimate entitlement based on legal issues of coverage under the Bond. (Stipulation, R. at 2850-2853.) Aetna reserved the

right to appeal which part, if any, of the reasonable legal fees are actually attributable to claims covered under the Bond.

The trial court erred in finding that the fees for the Armitage defense were wholly covered under the Bond. The Armitage verdict was based on claims which were not covered by the Bond, i.e., securities and truth-in-lending violations. Aetna's liability, if any, to Home for defense costs in the Armitage litigation should be limited to the proportion of fees attributable to covered allegations, and it should not include fees and costs for losses outside the Bond's coverage.

CONCLUSION

In this appeal, a favorable decision on any of Aetna's first four points (Points I-IV), requires reversal of the trial court's decision and the entry of judgment in Aetna's favor. Those points are absolute defenses. Section 11 of the Bond barred Home's claim against Aetna because Home knew Larry Glad was dishonest before it contracted with Aetna. Aetna never accepted any risks or premiums related to that known dishonest employee. Home also "discovered" its loss, as that term is defined in the contract, during the F&D bond period. In addition, Home failed to disclose either Glad's dishonesty or its actual and pending losses on the AFCO investor loans in the Aetna Bond Application process. And

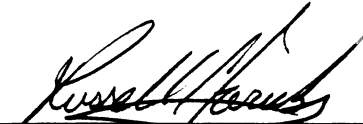
finally, the transactions for which Home was held liable in Armitage constituted trading in securities, which were excluded from coverage.

If the Court disagrees with all the preceding points, then the case should nevertheless be remanded for further proceedings on two separate grounds. The conduct of Home's management constituted a separate or superseding cause of Home's losses, and a jury should be allowed to make that determination. (Point V.) In addition, F&D was an indispensable party to this action, and the jury should have had the opportunity to decide which of the two sureties (if either) should have provided coverage. (Point VI.) If the Court of Appeals does not agree that all of the foregoing points entitle Aetna to a favorable ruling, then Home's judgment should be reduced as set forth in Points VII and VIII.

A just and equitable result requires reversal of the trial court's rulings and judgment with instructions to enter judgment in Aetna's favor based on one or more of the sound points of this appeal.

DATED this 6th day of August, 1990.

RICHARDS, BRANDT, MILLER
& NELSON

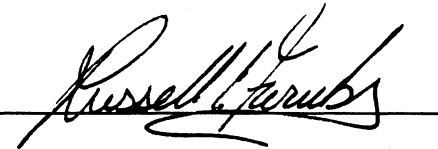


LYNN S. DAVIES
RUSSELL C. FERICKS
Attorneys for Appellant

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing instrument was HAND DELIVERED on this 6th day of August, 1990, to the following counsel of record:

Gary R. Howe
P. Bryan Fishburn
CALLISTER, DUNCAN & NEBEKER
Suite 800 - Kennecott Building
Salt Lake City, Utah 84133



HOME/C/LDW
6724-596