IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA

Alexandria Division

BUILDING ONE SERVICE SOLUTIIONS, INC.,	)	Civil No. 02-311-A
Plaintiff,	)	
v.	)	
NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA,	)	
Defendant	)	

MEMORANDUM OPINION

This matter is before the Court on Defendant's Motion for Partial Summary Judgment.

I. Background

Plaintiff Building One Service Solutions, Inc. ("Building One") alleges that it suffered a multi-million dollar loss when one of its former employees, Milton Marder ("Marder"), implemented a vast scheme in an effort to defraud and embezzle funds from Building One.

Marder was formerly the head of Interstate Building Services ("IBS"), a subsidiary of Building One. The thrust of Marder's connivance was an effort to manipulate the books of IBS such that IBS appeared profitable on paper to its parent Building One. But in truth, IBS sustained terrible losses, due in part to the fact that Marder had embezzled hundreds of thousands of

dollars for his own gain.

Following these losses, on October 6, 2000, Building One filed a claim of loss under its fidelity insurance policy with Defendant National Union Fire Insurance Company of Pittsburgh, Pennsylvania. ("National Union"). On March 1, 2002, frustrated with what it believed was an inexcusable delay in receiving its benefits under this policy, Building One filed this four count Complaint[1] against National Union. Specifically, Building One's Complaint requested both monetary and declaratory relief based on National Union's alleged failure to compensate Building One for its loss according to the terms of the insurance contract.

On May 20, 2002, National Union issued a check to Building One in the amount of $594,428.71, which National Union claimed represented the amount it owed Building One under the terms of the insurance policy.[2] But Building One claims that this figure grossly underestimates the losses it suffered that are covered by the insurance policy. Specifically, Building One argues that Marder's actions caused it to suffer $9,107,165.00 in losses covered by the insurance policy. Consequently, Building

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[1] The Court subsequently granted summary judgement in favor of the Defendants on Count III of the Complaint.

[2] This figure represents the $599,428.71 loss that National Union claims is attributable to Marder's embezzlement, less the $5,000.00 deductible included in the policy. Incidentally, the parties also agreed that payment of these funds was not an accord and satisfaction of Building One's claim.

One instituted this action based on its claim of entitlement to an additional $4,400,571.29 owed under the policy.[3]

National Union brings this motion for partial summary judgment requesting judgment on Count II and Count IV of Building One's Complaint. In particular, National Union argues that Building One is not entitled to declaratory relief that its losses are covered up to the policy limits, because the uncontroverted evidence shows that Building One cannot demonstrate covered losses beyond the almost $600,000.00 already paid. Secondly, National Union contends that, as a matter of law, Building One is not entitled to attorney's fees in this case because the supposedly governing law in this case - the law of the state of Minnesota - does not provide a right to attorney's fees for a bad faith denial of an insurance claim. Building One opposes both of these arguments.

II. Standard of Review

Summary judgment is entered when a plaintiff "fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial." Stone v. Liberty Mut. Ins. Co., 105 F.3d 188, 190 (4th Cir. 1997) (quoting Celotex Corp. v. Catrett, 477 U.S. 317, 322 (1986)). "To prevail on a

[3] The parties agree that the insurance policy covers losses capped at $5,000,000.00.

motion for summary judgment, a party must demonstrate that: (1) there is no genuine issue as to any material fact; and (2) it is entitled to judgment as a matter of law." Id. (citing Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 250 (1986)).

III. Analysis

A. Count II: Building One's Request for Declaratory Judgment

In Count II of its Complaint, Building One requests declaratory relief, stating that National Union is obligated to compensate Building One for losses up to the policy limit of $5,000,000.00. In contrast, National Union asserts that the overwhelming majority of the losses claimed by Building One are not covered under the policy. Consequently, the issue before the Court as to Count II is whether the terms of the insurance agreement cover the losses claimed by Building One.

In relevant part, the insurance agreement provides that National Union shall compensate Building One for:

> Loss of Money,[4] Securities[5] and other property which the insured shall sustain resulting directly from one or more fraudulent or dishonest acts committed by an Employee, acting alone or in collusion with others. . . Dishonest or fraudulent acts as used in this

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[4] For purposes of the policy "'Money' means currency, coins, bank notes and bullion; and travelers checks, register checks and money orders held for sale to the public."

[5] For purposes of the policy "'Securities' means all negotiable and non-negotiable instruments or contracts representing either Money or other property and includes revenue and other stamps in current use, tokens, and tickets, but does not include Money."

> Insuring Agreement shall mean only dishonest or fraudulent acts committed by such Employee with the manifest intent: (a) to cause the Insured to sustain such loss; and (b) to obtain financial benefit for the Employee or for any other person or organization intended by the Employee to receive such benefit, other than salaries, commissions, fees, bonuses, promotions, awards, profit sharing, pensions or other employee benefits, earned in the normal course of employment.

The above coverage is subject to the following limitation, which holds that the coverage does not apply "(m) to damages of any type for which the Insured is legally liable, except direct compensatory damages arising from a loss covered under this Policy."

From these assembled terms, this dispute arises. Building One claims that its calculation of over $9,000,000.00 in damages attributable to Marder's acts are all covered by the above terms. Specifically, Building One's calculation includes losses attributable to IBS from 1999 and 2000. Indeed, Building One argues that the detailed losses from these years were a direct result of Marder's fraudulent scheme. In particular, Building One asserts that Marder's entire bookkeeping deception hinged upon IBS obtaining numerous accounts. Allegedly, Marder obtained all of these accounts for IBS by bidding for these accounts without any regard to whether such a bid was in IBS's best interests.

In contrast, National Union states that the only

covered losses in this case are the documented amounts embezzled by Marder. Furthermore, National Union claims that the additional losses suffered by Building One are too attenuated from Marder's unlawful conduct for the policy to consider such losses a direct result of that unlawful conduct. Consequently, National Union claims that the declaratory action is unnecessary because it paid Building One all amounts owing under the policy, in the May 2002 payment.

The question presented is one of interpretation of an insurance contract. As this is a case which invokes this Court's diversity jurisdiction, the Court resolves substantive issues, such as contract interpretation, according to the law of the state in which the Court sits. See Erie R.R. Co. v. Tompkins, 304 U.S. 64, 78 (1938). Accordingly, this Court turns to the law of the Commonwealth of Virginia.[6]

The Virginia state courts have yet to construe the precise meaning and interpretation of the language of fidelity insurance. See Gen. Analytics Corp. v. CNA Ins. Cos., 86 F.3d 51, 53 (4th Cir. 1996). But the Fourth Circuit has, by employing the tools of general insurance contract interpretation established by the Virginia courts, constructed an interpretation

[6] The conflicts of laws problems which surface in other aspects of this case are not nettlesome in resolving this issue because Virginia law does not conflict with the law of any other potentially interested state.

of fidelity insurance contracts. See Gen. Analytics Corp., 86 F.3d at 53-54. Indeed, the General Analytics case involved an employee dishonesty policy almost identical to the one at issue in this case.

In general, the Fourth Circuit explains that under Virginia law, employee dishonesty "policies are designed to provide coverage for a specific type of loss characterized by embezzlement which involves direct theft of money." Id. at 53 (citations omitted). In specific relation to this case, three questions of interpretation arise: (1) did Marder possess the requisite specific intent to enrich himself or specified third parties with the funds allegedly lost as a result of his actions; (2) were all of the alleged losses directly related to Marder's dishonest conduct; and (3) were the losses attributable to Marder outside the scope of coverage of the insurance agreement.

1. Marder's Intent

In General Analytics the Fourth Circuit focused on the element of employee intent in causing the complained of loss. Specifically, the Fourth Circuit held that "[e]stablishing intent is central to proving coverage under employee dishonesty policies. . . . [Indeed, such policies cover] dishonest employee conduct only when it is accompanied by (1) an intent to cause [the insured] to sustain a loss and (2) an intent to benefit the employee or some other third person." Id. at 53-54.

The New York courts have further distilled this intent requirement as it relates to coverage under employee fidelity insurance policies by observing that employee dishonesty schemes can be classified by where they fall on a continuum of behavior. See Aetna Cas. & Sur. Co. v. Kidder, Peabody & Co., 676 N.Y.S.2d 559, 563 (N.Y. App. Div. 1998)(citing Gen. Analytics, 86 F.3d at 53-54). Ultimately, the court held that depending on where the scheme could be placed on this continuum, coverage may or may not apply.[7] See id. Specifically, the Kidder, Peabody court held:

> An embezzler at one end of the continuum, necessarily intends to cause the employer the loss, since the employee's gains are directly at the employer's expense. At the other end of the continuum, not triggering fidelity coverage, is the situation where the employee's dishonesty at the expense of a third-party is intended to benefit the employer, since the employee's gain results from the employer's gain.

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[7] National Union devotes great attention to establishing that employee dishonesty resulting in theft from third parties, to whom the insured is legally liable, does not activate coverage for the insured in the event the third parties sue the insured and obtain judgments against the insured for the employee's theft. See, e.g., Lynch Properties, Inc. v. Potomac Ins. Co. of Ill., 140 F.3d 622 (5th Cir. 1998); Towne Mgmt. Corp. v. Hartford Accident & Indem. Co., 627 F. Supp. 170 (D. Md. 1985); 175 E. 74th Corp. v. Hartford Accident & Indem. Co., 416 N.E.2d 584 (N.Y. 1980). But these cases are inapposite to the instant case. In particular, Building One does not base its claim for coverage on amounts it has paid to third parties to compensate those third parties for the dishonest acts of Marder. Instead, Building One's claim is premised on the fact that Marder's scheme was dependent upon entering numerous contracts, and that in obtaining these contracts, Marder caused substantial losses to Building One, which had to fulfill the contracts for extraordinarily low payments. Consequently, the losses incurred to further Marder's scheme were solely inflicted upon Building One, not any third parties.

Kidder, Peabody & Co., 676 N.Y.S.2d at 563.

In this case, Marder's scheme falls somewhere in between the poles described in Kidder, Peabody. Marder's plot was not so efficient that it benefitted only himself. Indeed, believing Building One's theory of the case, Marder's plan necessitated losses far more extensive than the gains he personally received. Furthermore, the bulk of the losses inured to the benefit of third parties with whom IBS contracted, and little evidence is presented by Building One to suggest that these third parties were intended to benefit from Marder's plotting. But see Gen. Analytics, 86 F.3d at 54 ("if a dishonest act has the *unintended* effect of causing a loss to the employer or providing a benefit to the employee the act is not covered by the policy.")(Emphasis in original).

But it is likewise evident that Marder's ploy was not intended to benefit IBS or Building One. Indeed, Building One has presented sufficient evidence from its expert Ricardo Zayas ("Zayas") to raise a genuine question of fact as to whether Marder's actions were taken with the specific intent to cause harm to IBS and Building One. To the extent that National Union claims that Zayas' statements are non-specific and at times contradictory, this is an issue of witness credibility that is properly left to the jury and not addressed by a court on summary judgment. See Summerlin v. Edgar, 809 F.2d 1034, 1039 (4th Cir.

1987) ("Credibility of conflicting testimony is not, on a summary judgment motion, an issue to be decided by the trial judge.")

In sum, the issue of Marder's intent falls at some indeterminate point along the continuum described by the Kidder, Peabody court. Because evidence of Marder's intent, as it is presented to this Court in this motion, does not stand at either of the poles of that continuum, this Court cannot state that, as a matter of law, Marder possessed or lacked sufficient intent to preclude or mandate coverage under the insurance agreement. Consequently, this Court reaches the same conclusion as the Fourth Circuit in General Analytics, that the issue of the dishonest employee's intent is simply too fact sensitive to resolve at summary judgment.

2. Direct Nature of Building One's Losses

Virginia has never defined the term "direct loss" as that term is used in an employee fidelity insurance policy. Moreover, Virginia courts have never defined the term "direct loss" standing alone in any insurance contract. Indeed, even the limited definition that Virginia courts have given to this term is, in part, contradictory.

Specifically, the Virginia Supreme Court has defined the term "resulting directly and independently of all other causes" as meaning that the that the plaintiff must demonstrate "proximate cause" to recover under the policy. Mutual Benefit

Health & Accident Ass'n v. Hite, 35 S.E.2d 743, 748 (Va. 1945)(interpreting life insurance contract). However, this Court held that the term "direct loss," when further modified by the term "direct physical damage caused by" did not require proof of proximate cause, but rather proof of "immediate . . . damage" in order for the plaintiff to prevail. Florists Mut. Ins. Co. v. Tatterson, 802 F. Supp. 1426, 1433 (E.D. Va. 1992)(Doumar, J.)(citing Abady v. Hanover Fire Ins., 266 F.2d 362, 363 (4th Cir. 1959))(both interpreting a property damage insurance policy).

In this case, the language of the insuring agreement is more similar to the language interpreted by the Virginia Supreme Court. Importantly, the language in this insuring agreement does not contain modifying language to the effect of "direct loss caused by . . . ." Rather, its use of the term "loss resulting directly from" more closely parallels the language interpreted by the Virginia Supreme Court in equating such language to a standard of proximate cause.

Furthermore, the Third Circuit came to a similar conclusion equating "direct loss," as used in employee dishonesty insurance, with the legal concept of proximate cause. See Resolution Trust Corp. v. Fid. & Deposit Co. of Md., 205 F.3d 615, 654-56 (3d Cir. 2000). Specifically, the Third Circuit held "a jury must determine the cause of the [complained of] loss that

[the insured] sustained and in particular, whether those specific dishonest and fraudulent acts upon which the [insured] bases its claim of indemnification proximately caused the loss." Id. at 656.

In Virginia, proximate cause is defined as an "act or omission which, in natural and continuous sequence, unbroken by an efficient intervening cause, produces the event, and without which that event would not have occurred." Commercial Distribs., Inc. v. Blankenship, 397 S.E.2d 840, 847 (Va. 1990) (quoting Banks v. City of Richmond, 348 S.E.2d 280, 282 (Va. 1986)). Indeed, "[a] critical question in determining whether an event is the proximate cause of an injury is whether there exists a self-operating, intervening cause, disconnected from the primary cause, that produced the injury." Tatterson, 802 F. Supp. at 1433-34 (citing Banks, 348 S.E.2d at 283).

So, the question presented to the Court in this motion, is whether Marder's implementation of his fraudulent scheme was the primary and unbroken cause for the over $9,000,000.00 in losses suffered by IBS and claimed by Building One in this policy. Of course, National Union and Building One offer different answers to this critical question.

In support of its position, National Union states that the majority of Building One's losses were the result of (1) Marder's poor business judgment exercised on behalf of IBS,

independent from any fraudulent scheme he may have concocted; and (2) the brutally competitive and risky business environs of the construction clean-up industry in which IBS participated. National Union claims that even Building One's experts cannot precisely separate the effect of market conditions and any scheme concocted by Marder in contributing to Building One's losses. Thus, National Union concludes that Building One's damages in excess of $600,000.00 were proximately caused by the conditions of the marketplace and some perhaps unwise business decisions made by Marder in that marketplace, not some vast fraudulent scheme implemented by Marder.

In contrast, Building One claims that its losses on the contracts entered into by Marder were proximately attributable to Marder's artifice of embezzlement. Specifically, Building One has produced evidence from its expert witnesses in construction and forensic accounting that Marder entered contracts as a means of covering-up his embezzlement scheme and for no other legitimate business purpose. Indeed, Building One claims that Marder entered these contracts to further his embezzlement at the expense of Building One. Therefore, Building One concludes that the losses it realized in fulfilling these contracts resulted directly (i.e., proximately) from Marder's fraud.

The evidence at the foundation of these contradicting theories on the proximate cause of Building One's financial

losses from IBS contracts credibly supports both Building One and National Union. Indeed, although National Union claims that Building One's expert testimony is contradictory at times and lacks specificity, these are questions best reserved for the trier of fact, because they address the weight and sufficiency of the evidence establishing the proximate cause of the loss. See, e.g., Tatterson, 802 F. Supp. at 1433-34 n.12; Resolution Trust Corp., 205 F.3d at 657. Therefore, because National Union has not presented evidence "that the facts pertaining to the issue of proximate causation are so one-sided" in its favor, this Court will not enter "judgment as a matter of law in its favor." Resolution Trust Corp., 205 F.3d at 657.

3. Other Reasons for Excluding Coverage

Additionally, National Union claims that the losses alleged by Building One as attributable to Marder are not covered by the plain terms of the insuring agreement. Specifically, National Union claims that Building One has not specified a "present loss" of "Money or Securities" that are "owned by the insured" or "for which the insured is legally liable."

In support of this contention, National Union asserts that the damages claimed by Building One are no more than the value of its liabilities to third parties. Moreover, National Union states that because legal liabilities to third parties are not losses covered by employee dishonesty policies, such

liabilities are not compensable in this case. See Kidder, Peabody, 676 N.Y.S.2d at 563 (settlements paid to third parties arising out of lawsuits by those parties for dishonest conduct of the insured's employee are not covered by employee dishonesty insurance policy.). Indeed, the Kidder, Peabody decision rightly holds that liabilities to third parties are not covered under fidelity policies because the ultimate compensation flows to a third party that never held an insurable interest. See id.

In contrast, Building One claims that the loss is covered by the express language of the agreement. Specifically, Building One asserts that the claimed losses in this case are those incurred on the contracts it fulfilled that were entered by Marder in furtherance of his fraudulent scheme to embezzle money from Building One. Moreover, Building One states that it fulfilled these contracts and it is not claiming a right to compensation based on any existing liability to any third party.

Building One's argument is premised on the contention that the losses it suffered were attributable to the contracts entered into by Marder in furtherance of his fraudulent scheme. Under the language of the insuring agreement, losses occurring to any "securities," which result directly from the fraudulent acts of the employee are covered by the insurance agreement. In this policy the term "securities" is defined to include "all negotiable or non-negotiable instruments or contracts

representing either Money or other property." Furthermore, the evidence presented by Building One in this case indicates that the losses it claims stem from the contracts it held, which entitled it to the payment of money. Consequently, substantial evidence exists to create at least a genuine issue for trial as to whether the claimed loss is covered by the policy.

Moreover, in rejecting National Union's motion for summary judgment on this issue, the Court rejects National Union's argument that simply because the contracts themselves were not misappropriated or created fraudulently, losses deriving therefrom are non-compensable under the insuring agreement. Although the "resulting directly" language of the insuring agreement limits the scope of the insurer's risk significantly, it does not limit that risk solely to the money that is eventually found in the embezzler's pocket.

In particular, the exception to exclusion (m) which provides that the insurer will cover "direct compensatory damages arising from a loss covered under this policy" narrows the coverage only to those losses that are recognized as proximately related to the embezzlement scheme itself. Importantly, the exception to exclusion (m) provides enough latitude that all compensatory damages associated with the employee's dishonesty are covered, not just the amounts the employee embezzled, but

also those proximately related to the entire scheme.[8] In contrast, had the insurer intended only to provide coverage for the amounts actually embezzled from the employee, by including language covering only "actual loss" then a different result may have been warranted.

In sum, on the evidence presented to this Court in this motion, genuine questions of the following material facts exist: (1) whether Marder intended to use these many subcontracts as an artifice to defraud Building One and enrich himself; (2) whether Building One's alleged damages resulted directly from the fraudulent acts of Marder, that is, whether Marder's acts proximately caused Building One's alleged losses; and (3) whether Building One suffered "compensatory damages" to contracts entered into by Marder on behalf of IBS. Because credible and substantial evidence is presented by both parties on all of these issues, summary judgement is inappropriate for Count II. Consequently, National Union's motion for summary judgment on Count II will be denied.

B. Count IV: Building One's Request for Attorney's Fees

The Court believes that significant factual issues remain unresolved, some of which are critical to determining

[8] Virginia defines compensatory loss as follows: "Compensatory damages are those allowed as a recompense for loss or injury actually received and include loss occurring to property, necessary expenses, insult, pain, mental suffering, injury to the reputation, and the like." Giant of Va., Inc. v. Pigg, 152 S.E.2d 271, 276 (Va. 1967).

which state's law applies to this action. But because the conflicts of law issues involve only the larger issue of whether attorney's fees are recoverable, the Court believes that this conflicts of law issue is best resolved after the completion of the trial.[9] Accordingly, National Union's motion for summary judgment on Count IV will be denied.

IV. Conclusion

For the foregoing reasons the Defendant's Motion for Summary Judgment as to Count II and Count IV of Plaintiff's Complaint will be denied. An appropriate Order will issue.

November 26th, 2002
Alexandria, Virginia

/s/
UNITED STATES DISTRICT COURT JUDGE

James C. Cacheris

[9] The trial will resolve liability on Count I and Count II and thus may render the conflicts of law issue wholly nugatory. Nevertheless, even if after the trial, Count IV remains an issue of contention, the Court could resolve such an issue at that time.

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NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA.,	)	
Defendant	)	

O R D E R

For the reasons stated in the accompanying Memorandum Opinion, it is hereby ORDERED that:

1) the Defendant's Motion for Partial Summary Judgment is DENIED;

2) the Clerk of the Court shall forward copies of this Order and the accompanying Memorandum Opinion to all counsel of record.

November 26th, 2002
Alexandria, Virginia

/s/
UNITED STATES DISTRICT COURT JUDGE