

IN THE COURT OF COMMON PLEAS FOR PHILADELPHIA COUNTY
FIRST JUDICIAL DISTRICT OF PENNSYLVANIA
TRIAL DIVISION – CIVIL

DOCKETED

JAN 22 2019

R. POSTELL
COMMERCE PROGRAM


JANNEY MONTGOMERY SCOTT LLC, : JUNE TERM, 2016
: :
Plaintiff, : NO. 00130
: :
v. : COMMERCE PROGRAM
: :
NATIONAL UNION FIRE INSURANCE : Control Nos.: 18083052, 180803054,
COMPANY OF PITTSBURGH, PA : 18083131
: :
Defendant. :

ORDER

AND NOW, this 22nd day of January, 2019, upon consideration of the parties' cross-Motions for Summary Judgment, defendant's Motion in Limine, the responses thereto, and all other matters of record, and in accord with the Opinion issued simultaneously, it is **ORDERED** as follows:

1. Defendant's Motion for Summary Judgment is **GRANTED in part**, and **JUDGMENT is ENTERED** in favor of defendant and against plaintiff on Count III of the Complaint for Fraud, on plaintiff's claims for attorneys' fees and costs incurred in the underlying litigation, and on plaintiff's claims for reimbursement of its clients' lost opportunity/use of invested funds;
2. Plaintiff's Motion for Partial Summary Judgment and the remainder of defendant's Motion for Summary Judgment are **DENIED**; and
3. Defendant's Motion in Limine is **DISMISSED** without prejudice to re-file it closer to the time of trial, if the plaintiff still intends to offer the expert's opinion at trial.

BY THE COURT:



NINA W. PADILLA, J.

Janney Montgomery Scott-ORDOP



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	:	
Defendant.	:	

OPINION

Defendant National Union Fire Insurance Co. of Pittsburgh, PA (“National Union”) issued a Financial Institution Bond (the “Bond”) to plaintiff Janney Montgomery Scott, LLC (“Janney”). In this action, Janney seeks

coverage from National Union for the significant loss [Janney] has incurred as a direct result of the dishonest and fraudulent acts of its former employee, Patricia Miller, including amounts Janney paid to the clients defrauded by Miller, amounts Janney incurred in defending against the clients’ claims, and claims expenses.¹

While working for Janney, and later at another brokerage firm, Ms. Miller “orchestrated a multi-million dollar Ponzi scheme.”² Several of the victims of her scheme were Janney’s (and Ms. Miller’s own) clients. Those clients filed claims against Janney, which were eventually settled or arbitrated, and which resulted in Janney allegedly incurring significant losses of approximately three million dollars.³

¹ Janney’s Motion for Summary Judgment (“Janney SJM”), ¶ 19.

² *Id.* at ¶ 24.

³ *Id.*, Exhibits 2 and 3.

Janney proffers deposition testimony⁴ and other disputed evidence to show that Ms.

Miller engaged in the following misconduct:

In orchestrating her fraudulent scheme, Miller used her Janney computer to create documents regarding the purported investments (such as fraudulent new account applications) and held all documents relating to the purported investments in her Janney office (such as checkbooks for ba[n]k accounts, bank records, and documents reflecting the purported investments). In addition, at times, Miller used Janney's fax machine to communicate with clients regarding the purported investments, and received client checks for the purported investments at her Janney office. Certain Janney clients also wrote out checks to invest in the purported investments from accounts they held at Janney.

Once she received the clients' funds, Miller would initially deposit the client checks into bank accounts over which she had sole control at two other financial institutions. The accounts were held in the name of KS Investment Club and Buckharbor Investment Club. Miller testified that she deliberately set up her Ponzi scheme so that the clients would deposit the money they took out of their Janney investments into a separate bank account (though, in some instances, the money was placed in a Janney checking account) before writing a check to one of the fraudulent investment accounts. She explained that "[t]here was no way for a client to tell [her] to move money from their Janney account directly to KS or Buckharbor because Janney would not have done that." Miller subsequently moved substantial sums of the stolen client funds into accounts held at Janney, including a brokerage account in the name of "KS Investment Partnership" and a joint personal account held by Miller and her husband.

With respect to the KS Investment Partnership account held at Janney, Miller later testified that the source of the funds in that account was "[f]or the most part," money Miller took from clients. Miller also later admitted that, in perpetrating her scheme, she stole two stock certificates from her husband, George Miller, and forged his name on the Irrevocable Stock Powers to sell, assign and transfer the shares of stock to Janney for deposit into accounts held at Janney.⁵

⁴ Under the Nanty Glo rule, the credibility of such evidence cannot be determined until trial. See Borough of Nanty-Glo v. Am. Sur. Co. of New York, 309 Pa. 236, 238, 163 A. 523, 524 (1932) ("However clear and indisputable may be the proof when it depends upon oral testimony, it is nevertheless the province of the jury to decide, under instructions from the court, as to the law applicable to the facts, and subject to the salutary power of the court to award a new trial if they should deem the verdict contrary to the weight of the evidence.")

⁵ Janney SJM, ¶¶ 37-46 (citations omitted).

While National Union does not concede all of the above stated facts, it relies upon the deposition testimony of Janney's corporate designee, Mr. Smith, to describe the elements of Ms. Miller's scheme:

[W]ith the exception of claimant Gropp, the funds at issue uniformly were withdrawn by clients from their Janney account and sent to their personal bank account outside Janney. The funds were then sent by the clients to KS Investments (i.e. Miller's outside bank accounts). At this point Miller either used the funds personally or transferred them to KS Investments at Janney (controlled by Miller). With respect to claimant Gropp, the Gropps withdrew funds from their checking account at Janney and sent them to the KS investment account (i.e. Miller's bank account) away from Janney.⁶

The question raised in the parties' cross-Motions for Summary Judgment is whether the Fiduciary Bond issued by National Union provides coverage to Janney for any of the amounts it expended in connection with Ms. Miller's fraudulent scheme.

I. The Bond May Provide Coverage for Janney's Payments to Clients for Ms. Miller's Theft of Investment Funds.

"Interpretation of an insurance policy [or similar contract] is a question of law that a court may resolve on a motion for summary judgment."⁷ The Bond under which Janney seeks coverage for Ms. Miller's Ponzi scheme states that National Union "agrees to indemnify the Insured [Janney] for:"⁸

Loss resulting directly from dishonest or fraudulent acts committed by an Employee acting alone or in collusion with others.
Such dishonest or fraudulent acts must be committed by the Employee with the manifest intent:
(a) to cause the Insured to sustain such loss; **or**
(b) to obtain financial benefit for the Employee or another person or

⁶ National Union's Motion for Summary Judgment ("National Union SJM"), ¶ 41 (citations omitted).

⁷ Harleysville Ins. Companies v. Aetna Cas. & Sur. Ins. Co., 568 Pa. 255, 258, 795 A.2d 383, 385 (2002).

⁸ Bond, Page 1 of 6. Under the Declarations, the "Insured" is "Janney Montgomery Scott LLC."

entity.⁹

There does not appear to be any dispute that Ms. Miller was Janney's "Employee," nor that Ms. Miller "committed" a series of "dishonest or fraudulent acts," in connection with her Ponzi scheme, nor that she committed those acts "to obtain financial benefit for [herself]." The only dispute arising out of this insuring clause is whether the payment of damages by Janney to its former customers constitutes a "[l]oss resulting directly from" Ms. Miller's dishonest and fraudulent acts.

There can be no serious quibble that the loss of the customers' investment funds resulted "directly" from Ms. Miller's theft, and her use for her own purposes, of those same funds. The salient question is whether the clients' loss can also be considered a loss to Janney because Janney reimbursed the client-victims for the misdeeds of its agent, Ms. Miller.

The payment of damages to reimburse customers for funds stolen from them by an employee appears to be a compensable loss under the Bond if it meets the following conditions:

This bond shall apply to loss of Property¹⁰ (a) owned by the Insured, (b) held by the Insured in any capacity, or (c) owned and held by someone else under circumstances which make the Insured responsible for the Property prior to the occurrence of the loss. This bond shall be for the sole use and benefit of the Insured named in the Declarations.¹¹

While there is no evidence that Ms. Miller stole any property "owned by" Janney, Janney has proffered evidence that a significant portion of the investment funds Ms. Miller stole from

⁹ Bond, Amended Fidelity Agreement, Rider 3 (emphasis added). The original form of the Fidelity Agreement set forth a conjunctive "and" rather than a disjunctive "or," so that both conditions (a) and (b) would have to have been met for there to be coverage. *See* Bond, Page 1 of 6.

¹⁰ "Property" is defined to include "Money, Certified Securities, Negotiable Instruments" and the like. Bond, p. 3 of 6.

¹¹ *Id.*, p. 6 of 6.

the clients were “held by the insured [Janney]” in Janney accounts prior to being withdrawn and given by the clients to Ms. Miller. There is also some evidence that investment funds may have been “owned and held by [either the clients or Ms. Miller] under circumstances which make [Janney] responsible for the Property prior to the occurrence of the loss.” The extent of Janney’s responsibility, if any, for the property held in non-Janney accounts will have to be established at trial.¹²

Several other provisions of the Bond lend support to the view that a covered “loss” under the Bond may include damages paid by Janney to third parties, including customers. For instance, the provisions regarding when “discovery” of a loss occurs refer to third party claims:

Discovery also occurs when a member of legal or internal audit department, vice president or executive vice president of the Insured receives notice of an actual or potential claim in which it is alleged that the Insured is liable to a third party under circumstances which, if true, would constitute a loss under this bond.¹³

Likewise, the Bond provisions regarding “notice” refer to legal proceedings brought against Janney:

The Insured shall notify the Underwriter at the earliest practicable moment, not to exceed 30 days¹⁴ after notice thereof, of any legal proceeding brought to determine the Insured’s liability for any loss, claim or damage, which, if established, would constitute a collectible loss under this bond. Concurrently, the Insured shall furnish copies of all pleadings and pertinent papers to the Underwriter.¹⁵

¹² In essence, Janney will have to prove its own liability to its customers in order to show that it may be entitled to coverage under the Bond.

¹³ Bond, Rider 15, “Definition of Discovery.”

¹⁴ The “Amended Notice [of] Legal Proceedings” changed the notice provision to “not to exceed 60 days.” *Id.*, Rider 13.

¹⁵ *Id.*, p. 2 of 6.

Such provisions contemplate that Janney’s legal “liability” for “damage” to a “third party” could constitute a “loss” under the Bond.

Similarly, one of the exclusions in the Bond, upon which National Union relies, supports the view that damages paid by Janney to reimburse its customers for its agent’s bad acts could constitute a “covered loss” to Janney. The exclusion states that the Bond does not provide coverage for

damages of any type for which the Insured is legally liable, **unless** the Insured establishes that the act or acts which gave rise to the damages involved conduct which would have caused a covered loss to the Insured in a similar amount in the absence of such damages[.]¹⁶

National Union would like to rely on just the first clause of this Exclusion (t) to satisfy its burden of establishing that Janney is barred from recovering under the Bond any “damages” it paid to its clients in settlement of, or judgment on, their claims. However, the remaining exception to the exclusion necessarily allows Janney to recover damages it paid to third parties if Ms. Miller’s dishonest or fraudulent acts “gave rise to those damages” and if they also “would have caused a covered loss” to Janney “in the absence of such damages.” Since, as set forth above, Janney has proffered some evidence that the clients’ stolen investment funds may constitute a covered loss to Janney under the Bond, the court cannot conclude at this juncture that Exclusion (t) precludes recovery; instead, it supports Janney’s potential recovery under the Bond.¹⁷

¹⁶ Bond, Exclusion (t), p. 4 of 6 (emphasis added). “Where an insurer relies on a policy exclusion as the basis for its denial of coverage and refusal to defend, the insurer has asserted an affirmative defense and, accordingly, bears the burden of proving such defense.” Madison Const. Co. v. Harleysville Mut. Ins. Co., 557 Pa. 595, 605, 735 A.2d 100, 106 (1999).

¹⁷ To the extent that this reasoning appears circular, it must be blamed on the lack of clarity in the terms of Exclusion (t) which renders them ambiguous in light of the other provisions of the Bond cited previously. Any such ambiguity must be interpreted against the drafter, National Union, and in favor of Janney. See Prudential Prop. & Cas. Ins. Co. v. Sartno, 588 Pa. 205, 212, 903 A.2d 1170, 1174 (2006) (“Where a provision of a policy is ambiguous, the policy provision is to be construed in favor of the insured and against the insurer, the drafter of the agreement.”)

II. Janney's Attorneys' Fees and Defense Costs Incurred in the Underlying Client Actions Are Not Covered Under the Bond.

Janney seeks reimbursement for the attorneys' fees and costs it incurred in defending against its defrauded clients' claims. However, the Bond expressly does not provide coverage for:

all fees, costs and expenses incurred by the Insured:
(1) in establishing the existence of or amount of loss covered under this bond, or
(2) as a party to any legal proceeding whether or not such legal proceeding exposes the Insured to loss covered by this bond.¹⁸

Despite Janney's arguments to the contrary, FINRA arbitrations constitute "legal proceedings" since they are an alternative to traditional actions at law or in equity and are favored by public policy.¹⁹ Therefore, any legal "fees, costs, and expenses" incurred by Janney in connection with such FINRA proceedings would not be covered under the above exclusion in the Bond. Although, the Bond does contain an exception if National Union elects to defend the legal proceeding against its insured, National Union apparently did not do so with respect to any of the underlying proceedings against Janney.

The Underwriter, at its sole option, may elect to conduct the defense of such legal proceeding, in whole or in part. . . .

If the Underwriter elects to defend the Insured, in whole or in part, any judgment against the Insured on those counts or causes of action which the Underwriter defended on behalf of the Insured or any settlement in which the Underwriter participates and all attorneys' fees, costs and expenses incurred by the Underwriter in the defense of the litigation shall be a loss covered by this bond.

If the Insured does not give the notices required in subsection (a) of Section 5 of the Conditions and Limitations of this bond and in the first paragraph of this

¹⁸ Bond, Exclusion (u), p. 4 of 6.

¹⁹ See *Fastuca v. L.W. Molnar & Assocs.*, 608 Pa. 187, 213, 10 A.3d 1230, 1245 (2011) ("the settlement of disputes by arbitration is favored by the public policy of this Commonwealth and is, therefore, encouraged by our courts and by statute.")

General Agreement, or if the Underwriter elects not to defend any causes of action, neither a judgment against the Insured, nor a settlement of any legal proceeding by the Insured, shall determine the existence, extent or amount of coverage under this bond for loss sustained by the Insured, and the Underwriter shall not be liable for any attorneys' fees, costs and expenses incurred by the Insured.²⁰

This provision confirms that Janney's legal fees and costs incurred in the underlying client litigation is not recoverable under the Bond.

Finally, Janney seeks to recover attorneys' fees based on an additional provision of the Bond related to "Claims Expenses:"

In consideration of the premium paid, it is hereby understood and agreed that:

1. The attached bond is hereby amended by adding to it an additional Insuring Agreement as follows;

CLAIMS EXPENSE

Reasonable expenses necessarily incurred and paid by the Insured in preparing any valid claim for loss as defined in Insuring Agreements A, B, C, D, E, and F, and any other valid coverage added by rider which loss exceeds the Single Loss Deductible Amount of \$500,000. The Underwriter's maximum liability for such expenses paid by the Insured in preparing any one such claim shall be \$50,000.

2. Nothing herein contained shall be held to vary, alter, waive or extend any of the terms limitations, conditions or agreements of the attached bond other than as above stated.²¹

While this provision may provide some additional coverage for fees and costs incurred by Janney in submitting its Proofs of Loss to National Union, this provision does not provide coverage for the presumably much larger fees and costs incurred by Janney in defending the underlying actions asserted against it by its clients.²²

²⁰ Bond, p. 2 of 6.

²¹ *Id.*, Rider 8.

²² The Bond also does not cover "indirect or consequential loss of any nature including, but not limited to, fines, penalties, multiple or punitive damages." *Id.*, Exclusion (v), p. 4 of 6. To the extent Janney paid any such penal amounts, they would not be covered, although purely compensatory damages it paid to its clients may be covered as set forth above.

III. Janney's Payments for Its Clients' Loss of Use of Investment Funds Are Not Covered Under the Bond.

According to Janney, it "ultimately reimbursed to the clients: (i) the monies the clients provided to Miller for 'investment;' and (ii) monies representing the clients' lost opportunity/use of those 'invested' funds."²³ However, the Bond expressly does not provide coverage for:

potential income, including but not limited to interest and dividends, not realized by the Insured or by any customer of the Insured.²⁴

The opportunity or use value of investment monies is necessarily their ability to generate income, including interest and dividends.²⁵ Therefore, such sums are not recoverable by Janney under the Bond.

IV. Janney May Have Provided Sufficient Notice of the Last Two Clients' Claims.

National Union asserts that Janney did not provide notice of the last two customer claims, filed by Mr. Sekula and Mr. Miller,²⁶ until Janney submitted its Fourth Supplemental Proof of Loss on April 17, 2018, which was too late. The notice provisions of the Bond state:

At the earliest practicable moment, not to exceed 60 days, after discovery of loss, by a member of legal or internal audit department, vice president or executive vice president[,] [Janney] shall give [National Union] notice thereof.²⁷

²³ Janney SJM, ¶ 56.

²⁴ Bond, Exclusion (s), p. 4 of 6.

²⁵ See Janney's Expert Report of Ron Van Epps, p. 4, attached as Exhibit R to National Union SJM (Expert claims to have "used a simple 6% annual rate of return to calculate estimated lost opportunity/use for each claimant per Counsel's instruction, except for George Miller whose damages are based on the market value of a stock. We did not use a compounding calculation; instead we took the net balance at the end of each year and calculated the lost opportunity/use for that year. The lost opportunity/use is not compounded in the subsequent year and does not accrue additional amounts.")

²⁶ Mr. Miller, the complaining customer, is/was the husband of Ms. Miller, the employee who ran the Ponzi scheme.

²⁷ Bond, Rider 13.

A federal criminal complaint was filed against Ms. Miller on May 29, 2014, and Janney apparently provided notice of a potential loss involving nine of its clients to National Union on June 30, 2014. At this time, National Union learned that it might be required to provide coverage under the Bond for losses associated with Ms. Miller's fraudulent acts.

Janney apparently subsequently learned of Mr. Miller's claim on November 13, 2015, and of Mr. Sekula's claim on January 25, 2016. On April 6, 2016, Janney submitted its Third Interim Proof of Loss to National Union, in which Janney represented that three complaints remained outstanding against it. Janney offers rather vague testimony from its corporate representative that he previously spoke to National Union's claims adjuster about those outstanding matters, which included Mr. Miller's and Mr. Sekula's claims.

Twelve days after the Third Interim Proof of Loss was submitted, National Union denied coverage for the third party claims arising out of Ms. Miller's fraudulent scheme. The timeliness of the Fourth Proof of Loss, subsequently submitted in 2018, is irrelevant since coverage had already been disclaimed.²⁸ However, the issue of whether Janney provided sufficient notice to National Union of Mr. Miller's and Mr. Sekula's claims in early 2016 will have to await determination at trial.

²⁸ See Strickler v. Huffine, 421 Pa. Super. 463, 477, 618 A.2d 430, 438 (1992) ("our caselaw clearly indicates that an insured is not forced to slavishly pursue useless compliance with technical policy requirements once an insurance company has denied coverage.")

Furthermore, this action for coverage was commenced in June of 2016, only two months after the 2016 Proof of Loss and National Union's coverage denial, but almost two years prior to the 2018 Proof of Loss. Presumably, National Union came to learn about all the underlying claims during the course of this litigation, prior to its receipt of the 2018 Proof of Loss.


V. Janney Cannot Sustain Its Fraud Claim.

Janney asserts a claim against National Union for fraud based on National Union's purported failure to provide coverage for the losses Janney incurred as a result of Ms. Miller's defrauding of their clients. Since such coverage may be available to Janney under the express terms of the Bond, and since the gist of the parties' relationship is contractual rather than tort-based, Janney may not proceed further against National Union for fraud.²⁹

CONCLUSION

For all the foregoing reasons, Janney's Motion for Partial Summary Judgment as to liability is denied and National Union's Motion for Summary Judgment is granted in part and denied in part.

BY THE COURT:



NINA W. PADILLA, J.

²⁹See Bruno v. Erie Ins. Co., 630 Pa. 79, 112, 106 A.3d 48, 68 (2014) (“If the facts of a particular claim establish that the duty breached is one created by the parties by the terms of their contract—i.e., a specific promise to do something that a party would not ordinarily have been obligated to do but for the existence of the contract—then the claim is to be viewed as one for breach of contract. If, however, the facts establish that the claim involves the defendant's violation of a broader social duty owed to all individuals, which is imposed by the law of torts and, hence, exists regardless of the contract, then it must be regarded as a tort.”)