SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

PRESENT: JUSTICE RICHARD B. LOWE III Justice

PART 56

Jacobsen

-v-

Natural Unicn

INDEX NO. 601325/10

MOTION DATE 2/10/11

MOTION SEQ. NO. 004

The following papers, numbered 1 to ____, were read on this motion to/for _____

Notice of Motion/Order to Show Cause — Affidavits — Exhibits _____ | No(s). _____

Answering Affidavits — Exhibits _____ | No(s). _____

Replying Affidavits _____ | No(s). _____

Upon the foregoing papers, it is ordered that this motion is

RECEIVED
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MOTION SUPPORT OFFICE
NYS SUPREME COURT - CIVIL

MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE
FOR THE FOLLOWING REASON(S):

Dated: 6/29/11

JUSTICE RICHARD B. LOWE III, J.S.C.

1. CHECK ONE: ..... ☐ CASE DISPOSED ☐ NON-FINAL DISPOSITION
2. CHECK AS APPROPRIATE: .....MOTION IS: ☐ GRANTED ☑ DENIED ☐ GRANTED IN PART ☐ OTHER
3. CHECK IF APPROPRIATE: ..... ☐ SETTLE ORDER ☐ SUBMIT ORDER
☐ DO NOT POST ☐ FIDUCIARY APPOINTMENT ☐ REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 56

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JACOBSON FAMILY INVESTMENTS, INC., JF INVESTMENT, L.L.C., JF-CRUT, L.L.C., MJ INVESTMENT, L.L.C., HOLD'EM INVESTMENT, LLC, JF FOUNDATIONS, L.L.C., MJ 2005 GRATS, LLC, GF INVESTMENT, L.L.C., GF-GRATS, L.L.C., MDG INVESTMENT, L.L.C., EDG INVESTMENT, L.L.C., SLG INVESTMENT, L.L.C., GF FOUNDATIONS, L.L.C., GF-CRUT, LLC, MDG 1994 GRAT, LLC, BSJ FOUNDATIONS, LLC, and SG FAMILY INVESTMENTS, LP,

Plaintiffs,

Index No. 601325/10

-against-

NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA, CONTINENTAL CASUALTY COMPANY, FIDELITY AND DEPOSIT COMPANY OF MARYLAND, and GREAT AMERICAN INSURANCE COMPANY,

Defendants.

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Hon. Richard B. Lowe, III

In motion sequence 002, plaintiffs Jacobson Family Investments, Inc. (JFI), JF Investment, L.L.C., JF-Crut, L.L.C., MJ Investment, L.L.C., Hold'em Investment, LLC, JF Foundations, L.L.C., MJ 2005 Grats, LLC, GF Investment, L.L.C., GF-Grats, L.L.C., MDG Investment, L.L.C., EDG Investment, L.L.C., SLG Investment, L.L.C., GF Foundations, L.L.C., GF-Crut, LLC, MDG 1994 Grat, LLC, BSJ Foundations, LLC, and SG Family Investments, LP move, pursuant to CPLR 3212, for partial summary judgment, declaring that (1) their claim for losses, as the result of Bernard L. Madoff's (Madoff) Ponzi scheme, are covered under the Financial Institution Bonds issued by defendants National Union Fire Insurance Company of

Pittsburgh, PA (National Union), Continental Casualty Company (Continental), Fidelity and Deposit Company of Maryland (Fidelity), and Great American Insurance Company (Great American), and are not barred by any exclusions; and (2) plaintiffs' loss under the Financial Institution Bonds includes the amounts disclosed in the November 30, 2008 statements issued to JFI by Bernard L. Madoff Investment Securities LLC (Madoff Securities).

Defendants National Union, Continental, Fidelity, and Great American cross-move, pursuant to CPLR 3212, for summary judgment, dismissing the complaint.

Background

Plaintiff JFI is a family management company that manages the assets and businesses of plaintiffs JF Investment, L.L.C., JF-Crut, L.L.C., MJ Investment, L.L.C., Hold'em Investment, LLC, JF Foundations, L.L.C., MJ 2005 Grats, LLC, GF Investment, L.L.C., GF-Grats, L.L.C., MDG Invetsment, L.L.C., EDG Investment, L.L.C., SLG Investment, L.L.C., GF Foundations, L.L.C., GF-Crut, LLC, MDG 1994 Grat, LLC, BSJ Foundations, LLC, and SG Family Investments, LP, which are various limited liability companies, limited partnerships, foundations and trusts established by members of the Jacobson and Gershwind families. Among other things, JFI manages the assets of these entities by selecting outside investment advisors who invest their assets. In 1998, JFI allegedly selected Madoff as one of these outside investment advisors.

Plaintiffs entered into Customer Agreements with Madoff Securities. The Customer Agreements refer to Madoff Securities as "the Broker" and the plaintiffs as "the Customer," and states that "the Broker is acting as the Customer's agent" (Affirmation of Robert Novack, Exhibit 8). Plaintiffs also entered into Trading Authorizations, each authorizing Madoff to buy, sell, and trade in stocks, bonds, options, and any other risk securities on their behalf. The Trading

Authorizations also gave Madoff the authorization to act for plaintiffs in respect to such purchases, sales, or trades, and all other things in the furtherance or conduct of such, and directed that Madoff's instructions were to be followed (Affirmation of Robert Novack, Exhibit 8). Plaintiffs transferred millions of dollars to Madoff to allegedly manage as an investment advisor.

In August 2007, JFI submitted an application for a Financial Institution Bond to National Union. In the application, JFI disclosed a list of those who were managing assets for them at the time, including Madoff, who was listed as managing assets of $123,806,948. In October 2007, National Union issued JFI a Financial Institution Bond (Primary Bond), naming the remaining plaintiffs as insureds under the Primary Bond. The Primary Bond covered the policy period from October 19, 2007 to November 1, 2008 and was later extended to March 2009. In addition to the Primary Bond, JFI purchased four additional Bonds (Excess Bonds) from defendants Continental, Fidelity, and Great American. The Excess Bonds incorporated, and were subject to, the same terms and conditions as the Primary Bond. The Excess Bonds were also extended to March 2009.

On December 11, 2008, the United States Securities and Exchange Commission filed a complaint against Madoff and Madoff Securities in the United States District Court for the Southern District of New York, charging them with securities fraud for a multi-billion dollar Ponzi scheme. In March 2009, Madoff was criminally charged with 11 felony counts, and that same month, pled guilty to all counts.

On December 12, 2008, JFI, through its insurance broker, Frank Crystal & Company, notified defendants that they were asserting claims under the Primary Bond and Excess Bonds for the losses caused by Madoff. On June 10, 2009, JFI, on behalf of itself and the other plaintiffs,

submitted plaintiffs' Proofs of Loss to defendants, claiming losses of $107,619,369.33, plus claims expenses to be determined. Plaintiffs claimed these losses principally under the Outside Investment Advisor Insuring Agreement contained in Rider 14 of the Primary Bond. By letter dated March 18, 2010, defendants denied plaintiffs' claims under the Primary and Excess Bonds.

On June 7, 2010, plaintiffs filed this action for breach of the implied covenant of good faith and fair dealing and breach of contract. Plaintiffs now move for partial summary judgment declaring that (1) their claim for losses, as the result of Madoff's Ponzi scheme, are covered under the Primary and Excess Bonds, and are not barred by any exclusions and (2) plaintiffs' loss under the Primary and Excess Bonds includes the amounts disclosed in the November 30, 2008 statements issued by Madoff Securities. Defendants cross-move for summary judgment dismissing the complaint.

Analysis

The first issue presented in this matter is whether plaintiffs' losses, as a result of Bernard Madoff's dishonest acts, are covered under the Primary and Excess Bonds. Plaintiffs assert that Rider 14 of the Primary Bond provides coverage for dishonest acts by Madoff, as he is listed as an Outside Investment Advisor covered by this Insuring Agreement. Defendants argue that, because Madoff and Madoff Securities were broker-dealers, and not acting as investment advisors, they are not covered under this Rider.

Rider 14 states, in part,

1. The following Insuring Agreement will be added to the Policy:

Outside Investment Advisor

Loss resulting directly from the dishonest acts of any Outside Investment Advisor, named in the Schedule below, solely for their duties as an Outside Investment

> Advisor, on behalf of the Insured, committed alone or in collusion with others, except with a director or trustee of the Insured who is not an Employee, provided however, the Insured shall first establish that the loss was directly caused by dishonest acts of any Outside Investment Advisor which results in improper personal financial gain to such Outside Investment Advisor and which acts were committed with the intent to cause the Insured to sustain such loss.

Rider 14 defines Outside Investment Advisor as any firm, corporation, or individual named in the Schedule for the Insuring Agreement, Outside Investment Advisor, and an employee, officer, or Partner of such Outside Investment Advisor. Madoff is listed as an Outside Investment Advisor in the Schedule.

"The interpretation of written contracts which are clear and explicit is a matter for the courts to resolve" (*Eden Music Corp. v Times Square Music Publications Co.*, 127 AD2d 161, 164 [1st Dept 1987], citing *Mallad Constr. Corp. v County Fed. Sav. & Loan Assn.*, 32 NY2d 285, 291 [1973]). A contract is unambiguous if the language it uses has a definite and precise meaning (*Greenfield v Philles Records*, 98 NY2d 562, 569 [2002]). "[I]f the agreement on its face is reasonably susceptible of only one meaning, a court is not free to alter the contract to reflect its personal notions of fairness and equity" (*Id.* at 569-570). The language of Rider 14 has a definite and precise meaning, and thus, is unambiguous. In its clear and plain language, Rider 14 limits coverage to losses as a result of dishonest acts as an Outside Investment Advisor. As stated above, Rider 14 defines an "Outside Investment Advisor" as any firm, corporation, or individual named in the Schedule, including an employee, officer, or partner of such firm, corporation, or individual, and Madoff is clearly listed as one of the Outside Investment Advisors in the Schedule. Rider 14 does not require that those entities listed only be investment advisors; rather, the Rider limits the losses covered to those occurring out of the duties of an Outside Investment Advisor. If losses were suffered as a result of dishonest acts committed by Madoff in

his duty as an Outside Investment Advisor, those losses are covered.

However, while the language of Rider 14 is clear, an ambiguity exists when read with Exclusion (x). Section 2, Exclusion (x) states, in part,

> This bond does not cover:
> (x) loss resulting directly or indirectly from any dishonest or fraudulent act or acts committed by any non-Employee who is a securities...broker...

While this exclusion provides that losses as a result of any dishonest act committed by a securities brokers are not covered, its meaning is unclear when read with Rider 14. This creates an ambiguity that must be resolved by a trier of fact.

Madoff is clearly included as an Outside Investment Advisor on Rider 14; however, he was admittedly a registered securities broker. Although Exclusion (x) does not cover losses as a result of dishonest acts by a securities broker, it is not clear, when read with Rider 14, whether losses from dishonest acts by Madoff, acting as an Outside Investment Advisor, are automatically not covered, because Madoff is also a registered securities broker. This ambiguity presents a question of fact which cannot be resolved on these motions for summary judgment.

Defendants assert that plaintiffs are estopped from denying that Madoff and Madoff Securities were brokers, because they filed claims under the Securities Investor Protection Act (SIPA), alleging loss in the consolidated liquidation proceeding of Madoff Securities. However, as plaintiffs do not deny that Madoff and Madoff Securities were registered brokers, the SIPA claims do not support judicial estoppel, because they do not conflict with plaintiffs' position in this action.

As summary judgment is denied as to whether losses as a result of Madoff's dishonest acts are covered, defendants argue that their coverage obligations under the Bonds, if any, are

limited to plaintiffs' net investments, i.e. the money plaintiffs invested with Madoff, less any withdrawals. Defendants assert that plaintiffs actually withdrew more money from their Madoff accounts than they originally invested, incurring no actual loss, and therefore, they should not be able to recover under the Bonds.

Rider 14 provides coverage for "[l]oss resulting directly from the dishonest acts of [Madoff]." Plaintiffs argue that the term "loss" is undefined, and therefore, it would not be reasonable to limit losses to their net investments. The court disagrees. It cannot be reasonably argued that plaintiffs suffered a direct loss by not receiving the money reflected in the fictitious November 2008 statement, as that money never belonged to them and never existed (*see Horowitz v American Intl. Group, Inc.*, 2010 WL 3825737, *6, 2010 US Dist LEXIS 103489, *19 [SD NY 2010]). Plaintiffs cannot seek to recover something that they never owned.

Plaintiffs' inability to recover the full amount indicated on the November 2008 account statement is not a true loss, but rather, it is "as illusory as the initial, fraudulent gain" (*see Horowitz v American Intl. Group, Inc.*, 2010 WL 3825737 at *6, 2010 US Dist LEXIS 103489 at *21). A fraudulent loss after a fraudulent gain is not an actual loss (2010 WL 3825737 at *7, 2010 US Dist LEXIS 103489 at *23). Therefore, plaintiffs are only entitled to actual losses.

In the event that the court determined that plaintiffs' losses were limited to actual losses, the plaintiffs argue that defendants' cross motion for summary judgment must be denied, because defendants aggregated plaintiffs' losses and account balances to arrive at a single "net win" amount, when in fact, certain plaintiffs, who suffered actual losses, would be entitled to recover, if found that Madoff's dishonest acts are covered under the Bonds. In response, defendants withdraw their cross motion for summary judgment, without prejudice, solely on the issue of

aggregation, but still seek summary judgment, dismissing any claims of the plaintiffs who did not suffer actual losses and/or who did not incur losses in excess of the $3 million Single Loss Deductible. This portion of defendants' motion for summary judgment is denied.

Issues of fact exist as to which plaintiffs suffered actual losses, which plaintiffs did not, and which did not suffer losses in excess of the deductible. While defendants rely on Plaintiffs' Responses to Defendants' Joint First Set of Interrogatories (Affirmation of Robert Novack, Exhibit 20, pp. 18-19), the amounts of net cash flow into and out of the plaintiffs' Madoff Accounts, set forth by defendants in Question 17, are disputed by plaintiffs, who claim that the amounts listed are not reflective of the value of their investments on the November 2008 statements. Therefore, this determination must be made at trial.

Finally, defendants seek dismissal of plaintiffs' claim for breach of the implied covenant of good faith and fair dealing as an alleged result of defendants' bad faith in dragging out the investigation of, as well as the denial of, plaintiffs' claims under the Bonds. The complaint seek consequential damages for lost investment opportunities and legal costs, including attorneys' fees, as a result of this alleged breach.

"[C]onsequential damages resulting from a breach of the covenant of good faith and fair dealing may be asserted in an insurance contract context, so long as the damages were within the contemplation of the parties as the probable result of a breach at the time of or prior to contracting" (*Panasia Estates, Inc. v Hudson Ins. Co.*, 10 NY3d 200, 203 [2008] [internal citations and quotation marks omitted]).

In determining whether consequential damages were reasonably contemplated, "courts must look to the nature, purpose and particular circumstances of the contract known by the

parties ... as well as what liability the defendant fairly may be supposed to have assumed consciously, or to have warranted the plaintiff reasonably to suppose that it assumed, when the contract was made" (*Bi-Economy Mkt., Inc. v Harleysville Ins. Co. of N.Y.*, 10 NY3d 187, 193 [2008] [internal citations and quotation marks omitted]).

Plaintiffs argue that defendants took more than one year to deny coverage on facts that were self evident from the moment that the claim was filed and that this cost plaintiffs money and forced them to pursue this matter in court. However, it is not evident how these consequential damages were reasonably contemplated by the parties. Plaintiffs have not proven with reasonable certainty that defendants could foreseeably contemplate lost investment opportunities. Further, the consequential damages contemplated are no other than a loss of the use of money, which is what prejudgment interest is designed to compensate.

In addition, plaintiffs have failed to raise an issue of fact as to whether defendants acted in bad faith. In support of their motion, defendants present letters sent during the course of their investigation, seeking information from the plaintiffs, some of which were repeat requests (*see* Novack Affirmation, Exhibits 30, 32, and 33). These letters evidence that defendants were not purposely trying to drag out the investigation as plaintiffs' allege, but rather some of the delay in the investigation was the result of plaintiffs' conduct in responding to information requests. Thus, plaintiffs' claim for breach of the implied covenant of good faith and fair dealing is dismissed. In regard to the attorneys' fees sought by plaintiffs, an insured can recover the costs of litigation, including attorneys' fees, where an insurer refuses to pay a claim in bad faith (*Sukup v State of New York*, 19 NY2d 519 [1967]). Here, defendants have an arguable basis for their position in regard to payment under the Bonds, and therefore, attorneys' fees are not

warranted (*see Greenburgh Eleven Union Free School Dist. v National Union Fire Ins. Co. of Pittsburgh, PA*, 304 AD2d 334 [1st Dept 2003]).

Accordingly, it is

ORDERED that plaintiffs' motion for partial summary judgment is denied; and it is further

ORDERED that defendants' cross motion is granted only to the extent that any recovery by plaintiffs is limited to actual losses, and plaintiffs' claim for breach of the implied covenant of good faith and fair dealing, seeking consequential damages for lost investment opportunities and legal costs, including attorneys' fees, is dismissed.

Dated: June 29, 2011

ENTER:

HON. RICHARD B. LOWE III

J.S.C.