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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 11

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IAN STOKOE and DAVID WALKER, in their capacity as the Joint Official Liquidators of AJW OFFSHORE, LTD., AJW MASTER FUND, LTD., AJW OFFSHORE II, LTD., AND AJW MASTER FUND II, LTD., and AJW QUALIFIED PARTNERS, LLC, AJW QUALIFIED PARTNERS II, LLC, AJW PARTNERS, LLC, AJW PARTNERS II, LLC, NEW MILLENNIUM CAPITAL PARTNERS II, LLC, and NEW MILLENNIUM CAPITAL PARTNERS III, LLC,

Plaintiffs,

Index No. 651036/13

-against-

COREY RIBOTSKY, THE N.I.R. GROUP LLC, FIRST STREET MANAGER II, LLC, AJW MANAGER, and SMS GROUP, LLC,

Defendants.

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**MADDEN, JOAN A.:**

Defendants Corey Ribotsky (Ribotsky), the N.I.R. Group (NIR), First Street Manager II, LLC (First Street), AJW Manager and SMS Group, LLC (SMS) move, pursuant to CPLR 3211 (a) (1) and (7), to dismiss plaintiffs Ian Stokoe and David Walker's (together, the Liquidators) complaint.

FACTS

The facts for purposes of this motion to dismiss are taken from the complaint.

The Liquidators were appointed official liquidators of AJW Offshore, Ltd., AJW Master Fund, Ltd., AJW Offshore II, Ltd., and AJW Master Fund II, Ltd. (collectively, the Offshore Funds), and

AJW Qualified Partners, LLC, AJW Qualified Partners II, LLC, AJW Partners, LLC, AJW Partners II, LLC, New Millennium Capital Partners II, LLC, and New Millennium Capital Partners III, LLC (collectively the Onshore Funds; Onshore Funds together with Offshore Funds, the AJW Funds). Complaint, ¶¶ 12-15.

Ribotsky was the sole managing member of NIR and controlled the operations of NIR and its subsidiaries, First Street, AJW Manager, and SMS. *Id.*, ¶ 20. NIR is an investment advisory limited liability company. NIR directly or through its subsidiaries provided advisory and management services to the AJW Funds. *Id.*, ¶ 16. First Street, AJW Manager and SMS are NIR's wholly owned subsidiaries. *Id.*, ¶¶ 17-19.

The AJW Funds are a group of private investment funds under defendants management that invest in "Private Investment in Public Equities," or PIPE transactions. *Id.*, ¶ 31. PIPE funds lend money to publicly traded companies across the spectrum of size and financial strength.[1] *Id.* The funds were formed by Ribotsky, starting in 1999. *Id.*, ¶ 24. They focused primarily on distressed, start-up, microcap and emerging growth companies,

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[1]PIPE transactions involve the selling of publicly traded common shares or some form of preferred stock or convertible securities to private investors. In general, companies pursue PIPE's when capital markets are unwilling to provide financing and traditional equity market alternatives do not exist. Private Investment In Public Equities. (n.d.)In *Wikipedia.*, Retrieved April 16, 2014, from http://en.wikipedia.org./wiki/Private Investment In Public Equities.

which traded for pennies or fractions of a penny on the "Over-the-Counter Bulletin Board," known as the "Pink Sheets." *Id.*, ¶ 31. In return for their investments or loans, The AJW Funds generally received convertible debentures that were convertible into the issuer's common stock at a discount, ranging from 35% to 85% of the market price, at the time of the conversion. *Id.*, ¶ 32. Because of this discount, NIR was always able to record a paper profit in the form of unrealized gains whenever a PIPE transaction closed. *Id.*

Defendants earned management fees based on a percentage of the AJW Funds' total assets, and performance fees based on a percentage of the AJW Funds' annual returns. *Id.*, ¶ 33. Defendants were paid based upon the paper valuation of The AJW Funds' right to convert issuer stock, which, plaintiffs assert, were fictitious valuations and fictitious returns because there was a minimal market for the issuers stock and defendants knew it. *Id.*, ¶ 34. The AJW Funds' actual profits were negligible at best. *Id.*

In July 2004, Ribotsky personally invested in one of the AJW Funds on the same terms and conditions applicable to other investors, but instead of investing cash, Ribotsky assigned and transferred all of the assets of Equilibrium Equity, LLC (Equilibrium). Equilibrium was a private investment vehicle that Ribotsky had formed with another person, whom he later bought

out. Equilibrium made the same type of investments as The AJW Funds, and Ribotsky valued Equilibrium's assets at $581,525 based on his evaluation of Equilibrium's convertible debentures. No one but Ribotsky evaluated the worth of Equilibrium's assets. *Id.* ¶¶ 36-38. When Ribotsky transferred Equilibrium's assets to AJW Qualified Partners, he "credited himself with that amount in fund's capital account," leaving Equilibrium "an empty shell with no assets, expenses, income or distributions" ¶39.

Subsequently, Ribotsky converted certain promissory notes held by AJW Qualified Partners into issuer stock, and then delivered the stock to an Equilibrium brokerage account. He then sold the stock and transferred the proceeds to an Equilibrium account, over which he had sole control. This resulted in Ribotsky misappropriating a total of over one million dollars cash. *Id.*, ¶ 39.

In late 2007, it was clear that many of the issuers were defunct or on the verge of filing for bankruptcy, and could not make interest or principal payments on the loans. Rather than accept some issuers' offers to pay a lesser amount, Ribotsky caused the AJW Funds to issue new loans to the same delinquent issuers, with greater discounts in the stock conversion provisions, so that The AJW Funds continued to have paper profits and defendants continued to receive high fees on artificially inflated asset valuation and profit. *Id.*, ¶¶ 44-49.

Also in 2007, The AJW Funds did not generate enough cash to pay investor redemption requests. There was $39 million in outstanding investor redemption requests in AJW Qualified Partners, payable in June and September 2007, but that fund had only approximately $13 million in cash. However, during this time, AJW Offshore had $124 million in cash and only approximately $28 million in outstanding redemption requests. *Id.*, ¶ 50. Rather than close AJW Qualified Partners and disclose the losses, Ribotsky created AJW Master Fund, in which AJW Qualified Partners and AJW Offshore became investors. Ribotsky used this structure to take money from AJW Offshore to pay investors in AJW Qualified Partners. Defendants effectuated numerous intercompany transfers to satisfy redemption requests, commingling the assets of all of the AJW Funds. This was not for a proper business purpose, but to hide defendants' improper activities. *Id.*, ¶¶ 51-53. Further, defendants did not write down the value of the AJW Funds' investments even when their auditor's analysis showed that very few of the investments could be liquidated within four years or less, but continued to collect their fees based upon the overstated valuation. *Id.*, ¶¶ 54-57.

In November and December of 2008, rather than report year-end losses for the first time, defendants arranged a phony sale that enabled defendants to report a gain and collect fees. Ribotsky entered into nine separate transactions with Edward

Bronson (Bronson) in which the AJW Funds supposedly sold a portion of their portfolio for $43.2 million to entities owned or controlled by Bronson. However, Bronson did not pay cash for the transaction. He signed a series of promissory notes on behalf of the entities under his control, and executed personal guarantees. Based on this sale, defendants recorded $18 million in net realized gains on The AJW Funds' 2008 records, and charged The AJW Funds a performance fee based on those unrealized gains. The sale was a sham, with Ribotsky knowing in advance that Bronson would not pay the amount owed. The complaint quotes emails between Bronson and Ribotsky that support this conclusion. *Id.*, ¶¶ 60-63.

Plaintiffs allege that, in addition, defendants were grossly negligent in failing to conduct due diligence on prospective PIPE investments, and investing in several fraudulently operated companies, which exhibited the hallmark characteristics of a fraud. *Id.*, ¶¶ 65-68.

On September 28, 2011, the SEC initiated a lawsuit against Ribotsky and NIR. Plaintiffs maintain that they did not, and could not, have discovered defendants' wrongful conduct until defendants were removed from the management of the AJW Funds, which occurred in 2011. Plaintiffs allege that the AJW funds paid over $150 million in management and performance fees to NIR and its subsidiaries through the life of the funds, even though the

fees were based on fictitious valuations and unrealized profits. *Id.*, ¶ 74. Further, plaintiffs contend that they did not discover the wrongful conduct until the SEC asserted claims against Ribotsky and NIR in late 2011. *Id.*, ¶ 77.

Plaintiffs bring four causes of action against defendants: breach of fiduciary duty against all defendants; fraud against all defendants; breach of contract against First Street on behalf of the Offshore Funds; and unjust enrichment against all defendants. Plaintiffs seek actual, compensatory and other damages, including disgorgement of the management fees, prejudgement and post-judgment interest at the highest rate allowed by law, attorneys' fees and costs, and any further relief for which they are entitled at law and in equity.

DISCUSSION

Defendants seek dismissal of the complaint on the grounds that: the doctrine of in pari delicto precludes plaintiffs from bringing this action; the *Wagoner* rule, as set forth in *Shearson Lehman Hutton, Inc. v Wagoner* (944 F2d 114 [2d Cir 1991]), precludes plaintiffs from suing to recover for a wrong in which they essentially took part; the operating agreements and articles of association governing the AJW Funds shield defendants from the breach of contract claims and unjust enrichment claims because those claims are not supported by allegations of fraud, gross negligence or willful misconduct; and the three-year statute of

limitation has expired precluding any claim for breach of fiduciary duty.

In Pari Delicto

Defendants contend that since the Liquidators stand in the shoes of the AJW funds, they have no greater rights than such funds. Moreover, defendants argue that as the AJW funds benefitted from the purported wrongdoing alleged in the complaint, under the doctrine of in pari delicto the Liquidators cannot recover for any such alleged wrongdoing. In this connection, the defendants point to allegations in the complaint which they argue show that defendants' conduct benefitted the AJW Funds by giving them the appearance of a successful fund and thereby maintaining its continued success.

These allegations include, *inter alia*, that "Defendants employed a myriad scheme to conceal the deteriorating financial condition of the Issuers and further inflate the purported value of the AJW Funds' investments;" "by restructuring the PIPE investments in this manner, Defendants were able to simultaneously hide losses and create the illusion of benefit to the AJW Funds;" "AJW's financial statements from 2000 to 2007 showed a total of $407 million in returns." Complaint, ¶¶6,8,34.

Defendants' position is without merit. "The doctrine of in pari delicto mandates that the courts will not intercede to

resolve a dispute between two wrongdoers....The doctrine survives because it serves important public policy purposes. First, denying judicial relief to an admitted wrongdoer deters illegality. Second, in pari delicto avoids entangling courts in disputes between wrongdoers." *Kirschner v. KPMG LLP*, 15 NY3d 446, 464 (2010).

In general, the in pari delicto rule applies to bar claims by a corporation (or a party standing in the corporation's shoes) against third parties, when the corporation, through its agents acting within the scope of their duties, commits fraud (*see e.g. Kirschner v. KPMG LLP*, 15 NY3d 446 (barring claims by creditors and shareholders of corporation whose management engaged in fraud against auditor). In contrast, the application of the doctrine to claims asserted against corporate insiders has been rejected. *See e.g., In re Bernard L. Madoff Inv. Secs. LLC.*, 458 BR 87, 123 (Bkrtcy SD NY 2011)(noting that in pari delicto rules do "not apply to actions of fiduciaries who are insiders in the sense that they either are on the board or in management, or in some other way control the corporation"); *Global Crossing Estate Representative v Winnick*, 2006 WL 2212776, *15, 2006 US Dist LEXIS 53785, *53 (SD NY Aug. 3, 2006, 04 Civ 2558 [GEL])(same). "The rationale for the insider exception to the in pari delicto doctrine stems from the agency principles upon which the doctrine is premised; a corporate insider, whose wrongdoing is typically

imputed to the corporation, should not be permitted to use that wrongdoing as a shield to prevent the corporation from recovering against him." *In re Bernard L. Madoff Inv. Secs. LLC.*, 458 BR at 124, n. 26.

Next, defendants' reliance on *Buechner v Avery* (38 AD3d 443 [1st Dept 2007]) is unavailing. In *Buechner*, the First Department applied the doctrine of in pari delicto based upon the cooperation of the management of the bankrupt corporation with the defendant third parties. In that case, the corporation's controlling shareholder was aware of the subject transactions. Here, based on the allegations in the complaint, the shareholders were never informed of defendants' activities, and there is no third party involved in the action. Therefore, at least based on the allegations in the complaint, the position of plaintiffs and defendants in this action is not comparable to that in *Buechner*.

Furthermore, based on the allegations in the complaint, the doctrine of in pari delicto is inapplicable since it cannot be said that the alleged wrongdoing by the defendants was equal to or less then any conduct by the AJW Funds. *Rosenbach v. Diversified Group, Inc.*, 85 AD3d 569, 570 (1st Dept 2011)("[t]he doctrine of in pari delicto bars a party that has been injured as a result of its own intentional wrongdoing from recovering for those injuries from another party whose equal or lesser fault contributed to the loss"); *Stahl v Chemical Bank*, 237 AD2d 231,

232 (1st Dept 1997); *City of New York v Corwen*, 164 AD2d 212, 218 (1st Dept 1990); *Globaltex Group Ltd. v Trends Sportswear Ltd.*, 2010 WL 1633438, *4, 2010 US Dist LEXIS 39085, *9 (ED NY 2010). Specifically, while defendants are alleged to have engaged in fraudulent and other intentional wrongdoing, at most, the complaint alleges that the AJW Funds benefitted from defendants' wrongdoing. Accordingly, dismissal on the ground of in pari delicto is unwarranted.

The *Wagoner* Rule

Defendants next argue that this action is precluded by the *Wagoner* rule. The *Wagoner* rule denies a bankruptcy trustee standing to pursue a claim against a third party for wrongdoing to the corporation with the cooperation of management of the bankrupt company. *In re Bennett Funding Group, Inc.*, 336 F3d 94, 99-100 (2d Cir 2003). The *Wagoner* rule is a federal rule, and it is unclear whether the courts in New York State follow it. *See Kirschner v KPMG LLP*, 15 NY3d 446, 459 n 3 (2010); *cf Buechner v Avery*, 38 NY3d 443. However, it is unnecessary to resolve that issue, because this action is not against a third party, but against an insider. Therefore, the *Wagoner* rule is inapposite.

Contractual Exculpatory Clauses

Defendants contend that the exculpatory clauses in the AJW Funds' operating agreements and articles of association shield them from plaintiffs' breach of contract and unjust enrichment

claims. The agreements shield all defendants from claims arising from conduct not alleged to constitute fraud, gross negligence or willful misconduct.

Contrary to defendants' assertions, the complaint makes it clear that plaintiffs allege that defendants acted willfully, and at least grossly negligently, in ways to harm the AJW Funds so as to increase their own profits. Defendants' reliance on cases such as *Digital Broadcast Corp. v Ladenburg, Thalmann & Co., Inc.* (63 AD3d 647 [1st Dept 2009]) and *Kagan v HMC-New York, Inc.* (94 AD3d 67, 71 [1st Dept 2012]) is misplaced. In those cases, there were no allegations of intentional misconduct or gross negligence. Here, on the contrary, plaintiffs allege many actions on the part of defendants which were at best grossly negligent, including: "selling" a portion of the portfolio to Bronson, who Ribotsky knew was less than trustworthy, for nothing more than a promise, in order to create illusory gains on which to base defendants' fees; creating AJW Master Fund in order to enable Ribotsky to improperly transfer money between entities and hide the fact that the funds were losing money; diverting money to Ribotsky through his machinations with Equilibrium; and declining borrowers' offers to pay a reduced amount on their loans and, instead, reissuing the loans in a manner that would portray paper profits enabling defendants to obtain fees on those fictitious profits. These allegations are more than sufficient,

at this juncture, to overcome the exculpatory clauses' shield. *See Abacus Fed. Sav. Bank v ADT Sec. Servs., Inc.*, 18 NY3d 675, 683 (2012).

Unjust Enrichment

Defendants maintain that the fourth cause of action, for unjust enrichment, should be dismissed as duplicative of the fraud and breach of fiduciary duty's claims.

Where an unjust enrichment claim is based upon the same facts as a breach of contract or breach of fiduciary duty, it is duplicative of those causes of action and cannot stand. *Corsello v Verizon N.Y., Inc.*, 18 NY3d 777, 790-791 (2012). Plaintiffs allege that defendants deceived them by falsely stating the value of the assets and profits of the AJW Funds so as to obtain higher fees than they were entitled to receive. To the extent that those actions breached defendants' fiduciary duties and/or their contractual obligations, plaintiffs' success in pursuing such claims will make the unjust enrichment claim duplicative. To the extent that they may not succeed, unjust enrichment is not designed to remedy those defects. *Id.*

Contrary to plaintiffs' assertions, this situation is not analogous to those in *Vays v 139 Emerson Place* (94 AD3d 480 [1st Dept 2012]) or *Henry Loheac, P.C. v Children's Corner Learning Ctr.* (51 AD3d 476 [1st Dept 2008]). In both of those cases, there was a question whether a valid contract covered the issues

involved in the action. Here, there is no such question. Thus, the unjust enrichment claim is dismissed.

Statute of Limitations for Breach of Fiduciary Duty

Defendants contend that, since plaintiffs seek monetary damages, the three-year statute of limitations applies for the breach of fiduciary duty claims. NIR notified investors that there were insufficient funds to meet redemption requests in October 2008. Defendants maintain that the three-year statute of limitations should be applied from the date that investors knew about the lack of liquidity, and that, therefore, plaintiffs had until October 2011 to bring this action. This action was not commenced until March 2013. Therefore, defendants conclude that the breach of fiduciary duty claim is time-barred.

New York provides two statutes of limitations for a breach of fiduciary duty. When the relief sought is purely monetary, the limitations period is three years. *IDT Corp. v Morgan Stanley Dean Witter & Co.*, 12 NY3d 132, 139 (2009). When equitable relief is sought, the six year statute of limitations applies. *Id.* However, "where an allegation of fraud is essential to a breach of fiduciary duty claim, courts have applied a six-year statute of limitations under CPLR 213 (8)" *Id.*, citing *Kaufman v Cohen*, 307 AD2d 113, 119 (1st Dept 2003).

Plaintiffs argue that the six year statute of limitations applies since they seek equitable relief based on their claim for

disgorgement of improperly obtained fees, and since the allegations of fraud are essential to their breach of fiduciary duty claim. The argument as to disgorgement damages is unavailing as not only does the complaint primarily seek money damages, the disgorgement it seeks is monetary. *Id.*

However, plaintiffs' argument that the breach of fiduciary duty claim action is essentially a fraud action, such that the six year statute of limitations would apply has merit. *Kaufman v Cohen*, 307 AD2d 113; *Monaghan v Ford Motor Co.*, 71 AD3d 848, 850 (2d Dept 2010). Here, in addition to a free standing fraud claim, the complaint is permeated with allegations of substantial fraud by defendants, even if the word "fraud" is not used with respect to each of those activities. Based on the allegations in the complaint and construing the complaint liberally in favor of plaintiffs, as the court must do on a motion pursuant to CPLR 3211, the court concludes that, as pled, the breach of fiduciary duty claim is essentially a fraud cause of action subject to the six year statute of limitations and thus not time-barred.

In addition, plaintiffs' argument that the statute of limitations should be tolled because defendants concealed their activities until after the SEC brought its action against them potentially has merit. In order to establish a right to toll the statute of limitations, plaintiffs must allege facts to support a finding that actions of defendants prevented them from bringing

suit in a timely manner. *Corsello v Verizon NY, Inc.*, 18 NY3d at 789-790. Thus, defendants' failure to reveal their actions does not suffice unless they concealed their wrongdoing. *Id.* Only if defendants concealed their wrongdoing, can the statute of limitations be tolled. *Matter of Piccillo*, 19 AD3d 1087, 1089 (4th Dept 2005).

Defendants revealed, in 2008, that the AJW Funds were losing money. However, they did not reveal their actions which contributed, or perhaps caused, the situation, or that there was any wrongdoing. They remained in control of the funds until 2011, when plaintiffs were appointed as liquidators. During that time, since they were controlling the funds, they prevented anyone else from discovering their wrongdoing. Thus, at this stage of the litigation, it is fair to infer that they continued to conceal their activities by failing to accurately report to the shareholders the true situation of the funds.

Moreover, at this juncture, while it is unclear exactly what information defendants should have revealed, but withheld, it would be premature to make a determination as whether plaintiffs are entitled to the benefits of tolling before the parties have an opportunity to ascertain these facts. This is particularly true in view of the allegations that Ribotsky and NIR failed to provide the Liquidators with access to pertinent documents to enable them to liquidate the AJW Funds efficiently and

effectively. Complaint, ¶ 76. Such allegations suffice to support plaintiffs' contention that they could not have obtained the information earlier.

Accordingly, the motion to dismiss the breach of fiduciary duty claim on statute of limitations grounds is denied.

CONCLUSION

In view of the above, it is hereby

ORDERED that defendants' motion is granted only to the extent that the fourth cause of action for unjust enrichment is dismissed, and the motion is otherwise denied; and it is further

ORDERED that defendants are directed to serve an answer to the complaint within 30 days after the efiling of this decision order with notice of entry; and it is further

ORDERED that counsel are directed to appear for a preliminary conference in Part 11, Room 351, 60 Centre Street, on June 26, 2014 at 9:30 am.

Dated: April 24, 2014

ENTER:

J.S.C.

HON. JOAN A. MADDEN

J.S.C.