[* 1]

SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY - PART 42

----------x

PIERRE J.M. SERNET, CARY SCHWARTZ, D.D.S., MATTHEW MANDEL, D.D.S., JOHN HIGHSMITH, D.D.S., LEO TITUS, BRAWLEY ASSOCIATES, INC. d/b/a BRAWLEY PARDINI FONZI, INC., DONALD N. JAYNE, D.D.S., RONALD AHLEGIAN, PAUL G. BEATTY, ROBERT ANDREWS, LINDA SALAZAR, WENDY COSTIKYAN AND MALCOM E. SMITH, JR.

Plaintiffs,

-against-

DECISION AND ORDER

INDEX NO.: 651302/13

TWIN CITY FIRE INSURANCE CO.

Defendant.

----------x

NANCY M. BANNON, J.

BACKGROUND

In this action commenced pursuant to Insurance Law § 3420(a)(2), the plaintiffs, investors in the now defunct GRINrx Corp., seek to recover on an unsatisfied judgment entered against the corporation, the defendant's insured. The defendant, Twin City Fire Insurance Company ("Twin City"), moves, pre-answer, to dismiss the complaint on the grounds of lack of standing (CPLR 3211[a][3]), failure to state a cause of action (CPLR 3211[a][7]) and documentary evidence (CPLR 3211[a][1]). The plaintiffs cross-move for summary judgment on their complaint pursuant to CPLR 3212. For the reasons set forth below, the defendant's motion is granted and the plaintiffs' motion is denied.

In the underlying action, *Sernet, et al. v GRINrx Corp.*, (Index No. 102912/11), the plaintiffs sought, *inter alia*, compensatory damages or restitution from GRINrx for its wrongful acts and conduct in connection with a private offering of convertible debt securities, the "GRINrx Series A Preferred Stock Offering." The plaintiffs claimed to have invested approximately $1,040,000 under the same offering plan, and to have executed purchase agreements with

GRINrx. However, no closing on the securities ever occurred which, the plaintiffs contend, violated the parties' agreements and rendered the offering material false and misleading in violation of section 10(b) of the Securities Exchange Act of 1934 and other statutes, and rendered their investments virtually worthless. Rather, GRINrx, which was to sell "revolutionary" teeth whitening products, ceased operations within 14 months of its start, following settlement of a patent infringement action against them, generated little or no revenue during its brief existence, and never paid on the plaintiff's notes, which became due in 2008. The underlying complaint alleged various theories of fraud, unjust enrichment and breach of contract. GRINrx defaulted in that action, and the plaintiffs were granted a judgment in the total sum of $1,662,119.45, including attorneys fees. The judgment remains unsatisfied as GRINrx is insolvent and Twin City rejected the plaintiffs' demand for payment.

In the instant action, the plaintiffs claim that, since GRINrx is defunct, pursuant to Insurance Law § 3420(a)(2) they are entitled to recover the amount of the judgment from defendant Twin City which had issued a Directors, Officers and Entity Liability policy to GRINrx. It is Twin City's position that the plaintiffs lack standing under Insurance Law § 3420(a) since the policy was not "issued or delivered" in New York State, but was issued in Indiana and delivered in Washington. The defendant further argues that, in any event, the judgment is uninsurable under New York decisional authority, since the judgment essentially requires GRINrx to disgorge or return ill-gotten gains to the plaintiffs and under the terms of the policy, which excludes all losses arising from its contractual liabilities as well as all dishonest or wrongful acts or conduct of the insured. The defendant argues that, since GRINrx would thus not be entitled to recover under the policy, the plaintiffs, who have no greater rights, are not entitled to recover under Insurance Law § 3420(a)(2).

DISCUSSION

(1) Motion to Dismiss; Lack of Standing; CPLR 3211(a)(3)

The complaint must be dismissed as the plaintiffs are not entitled to relief under Insurance Law § 3420. It is a well settled principle that any "legislative enactment in derogation of common law, and especially those creating liability where none previously existed, must be

strictly construed (citations omitted)." Vucetovic v Epsom Downs, Inc., 10 NY3d 517, 521 (2008); see Allstate Ins. Co. v Rivera, 12 NY3d 602 (2009); Oden v Chemung County Indus. Dev. Agency, 87 NY2d 81 (1995); Staruch v 1328 Broadway Owners, LLC, 111 AD3d 698 (2nd Dept. 2013); McKinney's Cons Laws of NY, Book 1, Statutes § 301(a). Insurance Law § 3420 must be given a narrow construction as it is in derogation of the common law of torts and imposes liability upon insurers which did not exist in common law. See Lang v Hanover Ins. Co., 3 NY3d 350 (2004). "Under common law, an injured person possessed no direct cause of action against the insurer of a tortfeasor due to lack of privity of contract. See Lang v Hanover, [supra at 354]. Thus, 'if the insured was insolvent, so that the person injured or the estate of one killed was unable to satisfy the judgment against him, the insurer in effect would be released.' Id. *quoting* Jackson v Citizens Casualty Co., 277 N.Y. 385, 389 (1938). "[T]he Legislature remedied this inequity by creating a *limited* [emphasis supplied] statutory cause of action on behalf of injured parties directly against insurers", which is presently codified at Insurance Law § 3420. Id.

Indeed, the language of the statute itself mandates a narrow construction. Insurance Law § 3420 is entitled "Liability insurance; standard provisions; right of injured person" and clearly covers liability policies for death and personal injury and property damage. Section (a) of the statute defines its scope by providing in part that "No policy or contract insuring against liability for injury to person, except as provided in subsection (g) of this section, or against liability for injury to or destruction of property, shall be issued or delivered in this state unless it contains in substance the following provisions that are equally or more favorable to the insured and to judgment creditors so far as such provision relates to judgment creditors. The statute makes no mention of the type of policy at issue here.

The subject policy is a "Directors, Officers and Entity Liability" policy, and does not concern any personal injury or death or property damage loss. In fact, it expressly excludes, in section III(A), any claims for "bodily injury, sickness, disease, or death of any person, or damage to or destruction of any tangible property." The plaintiffs cite, and research reveals, no decisional authority to support their contention that the statute was intended to apply to this policy. Nor can the plaintiffs reasonably argue that Insurance Law § 3420 was intended by the Legislature to serve as a type of safety net for sophisticated investors to recoup their losses on

speculative business ventures once the business fails. If that were the case, the statute would read quite differently.

Appellate courts have interpreted the statute narrowly. For example, the written notice of disclaimer provision of CPLR § 3420, subsection (d), has been held to be inapplicable to environmental damage claims (Keyspan Gas East Corp. v Munich Reinsurance America, Inc., 23 NY3d 583 [2014]), property damage claims (see Legum v Allstate Ins. Co., 33 AD3d 670 [2nd Dept. 2006]) and breach of contract claims (Preserver Ins. Co. v Ryba, 10 NY3d 635 [2008]). As stated by the Court of Appeals in Keyspan, "[t]he Legislature enacted section 3420(d)(2) to 'aid injured parties' by encouraging the expeditious resolution of liability claims [cites omitted]" and "chose to limit [the section] to accidental death and bodily injury claims" and "it is not for the courts to extend the statutes prompt disclaimer requirement beyond its intended bounds." While in those cases it was the notice provision, subsection (d)(2), which was primarily at issue, the holdings indicate the intended scope of the statute.

The defendant's additional standing argument is that the policy was not "issued or delivered" in New York State but was issued in Indiana, where the defendant is located, and delivered in Washington, where GRINrx' maintained its principal place of business. The plaintiffs do not dispute those facts, but argue that they nonetheless have standing since GRINrx also had a New York facility and developed its product within the state. The plaintiffs arguments are unavailing, particularly in light of the reasoning set forth above.

(2) Motion to Dismiss; Failure to State a Cause of Action; CPLR 3211(a)(7)

In considering a motion to dismiss for failing to state a cause of action under CPLR 3211(a)(7), the pleading is to be afforded a liberal construction (CPLR 3026) and the court must accept as true the facts alleged in the complaint, accord the pleading the benefit of every possible inference, and only determine whether the facts, as alleged, fit within any cognizable legal theory. See Hurrell-Harring v State of New York, 15 NY3d 8 (2010); Leon v Martinez, 84 NY2d 83 (1995). For the reason stated in section (1), and below, the plaintiffs' complaint fails to state a cognizable claim against the defendant insurer under Insurance Law § 3420.

Defendant Twin City correctly argues that the plaintiffs' loss and the judgment against GRINrx are uninsurable under the controlling authority. The First Department has held that "the risk of being directed to return improperly acquired funds is not insurable" since "restitution for ill-gotten funds does not constitute 'damages' or 'loss' as used in insurance policies." See Vigilant Ins. Co. v Credit Suisse First Boston Corp., 10 AD3d at 528 (2004). Where an insured "purposely and intentionally comit[s] active and deliberate dishonesty", the matter falls "squarely within the liability exclusion of the D&O policy." Serio v National Union Fire Ins. Co. of Pittsburgh, PA, 18 AD3d 319, 321 (1st Dept. 2005). Such loss is simply "uninsurable under New York Law." Id. Even where there was an agreement to enter a consent order to disgorge "improperly acquired funds", a similar policy exclusion was found applicable by the First Department so as to warrant dismissal of breach of contract claim against the insurer. See Millenium Partners, L.P. v Select Ins. Co., 68 AD3d at 420 (1st Dept. 2009). "The public policy rationale for this rule is that the deterrent effect of a disgorgement action would be greatly undermined if wrongdoers were permitted to shift the cost of disgorgement to an insurer, thereby allowing the wrongdoer to retain the proceeds of his or her illegal acts." J.P. Morgan Securities Inc., v Vigilant Ins. Co., 91 AD3d 226, 230 (1st Dept. 2011) *rev'd on other grounds* 21 NY3d 324 (2013). The subject policy reflects this policy by expressly excluding coverage for "matters that may be deemed uninsurable under the law pursuant to which this policy shall be construed." Since the plaintiffs may only recover under the policy in this action to the extent that GRINx would be afforded indemnification coverage (see Royal Zenith Corp. v. New York Marine Managers, Inc., 192 AD2d 390 [1st Dept. 1993]), they have no claim.

Notably, the plaintiff in J.P. Morgan Securities Inc., v Vigilant Ins. Co., supra, was the insured, rather than the investor so it was not proceeding pursuant to Insurance Law § 3420 after a default by the corporation in which it invested. Rather, the insured plaintiff sought to be reimbursed for a disgorgement which consisted largely of profits realized by others as a result of its actions rather than its own "illicit gains" of profit or revenue. Thus, while the Court in that case denied the insurer's motion to dismiss under CPLR 3211(a)1) and (a)(7), that cases is factually distinguishable. Indeed, the Appellate Division cited with approval the cases which found in favor of the insurer and granted dismissal under circumstances comparable to this case, upon principles of contract law and public policy grounds. See e.g Vigilant Ins. Co. v. Credit Suisse First Boston Corp., supra. The Court further explained the cases relied upon by

the insurer, including Millenium Partners, L.P. v Select Ins. Co., supra, where "the insured was barred from obtaining coverage for SEC-ordered disgorgement because the SEC's findings 'conclusively link[ed]" the disgorgement payment to improperly acquired funds in the hands of the insured [citation omitted]." In other words, those cases directly implicated the policy rationale for precluding indemnity for disgorgement - to prevent the unjust enrichment of the insured by allowing it to, in effect, retain the ill-gotten gains by transferring the loss to its carrier." J.P. Morgan Securities Inc., v Vigilant Ins. Co., supra at 337.

As stated above, the plaintiff's prevailed in the underlying action and were awarded a money judgment upon the failure of the debtor corporation, GRINx, "to undertake and complete a private offering of securities" as agreed. By defaulting in that action, GRINrx did not challenge the plaintiffs' claims that it had improperly and dishonestly acquired the subject funds, the $1,040,000 or more invested by the plaintiffs, or that these funds constituted "illicit gains." Id. at 336. Accordingly, that issue is settled since the doctrine of res judicata applies to a judgment entered on default which has not been vacated. See Richter v Sportsmans Properties, Inc., 82 AD3d 733 (2nd Dept. 2011); Lazides v P&G Enterprises, 58 AD3d 607 (2nd Dept. 2009); CIBC Mellon Trust Co. v HSBC Guyerzeller Bank AG, 56 AD3d 307 (1st Dept. 2008). The plaintiffs, having been awarded a judgment in their favor, can not now disavow their prior position that GRINrx did, in fact, receive and retain their $1,040,000 investment, the "ill-gotten gains." Their present attempts to minimize the "ill-gotten gains" in order to avoid application of the public policy rationale is disingenuous. Indeed, the principle of judicial estoppel precludes them from doing so. See Casper v Cushman & Wakefield, 74 AD3d 669 (1st Dept. 2010); Bianchi v New York City Dept. of Housing and Community Renewal, 5 AD3d 303 (1st Dept. 2004), *lv app denied* 3 NY3d 601 (2004); D&L Holdings,LLC v RGC Goldman, LLC, 287 AD2d 65 (1st Dept. 2001).

In light of foregoing bases for dismissing the complaint, the court need not reach the defendant's argument that the subject policy expressly excludes coverage in these circumstances. However, the court notes that these provisions, which are broadly drawn in favor of the insurer, exclude, *inter alia*, "wrongful acts" on the part of the insureds and certain contractual liabilities incurred by them. The core of the plaintiffs' claims in the underlying action arose from their agreements with GRINrx, including purchase agreements, stock purchase

agreements, investor rights agreements, company business plans, notes and warrants, collectively referenced by the plaintiffs as the "Offering Materials", and GRINrx' wrongful conduct in improperly and dishonestly acquired the subject funds by means of these agreements.

(3) Motion to Dismiss; Documentary Evidence; CPLR 3211(a)(1)

It is well settled that a motion to dismiss upon documentary evidence will be granted if the evidence submitted utterly refutes the factual allegations of the complaint and conclusively establishes a defense as a matter of law. See Kopelowitz & Co. v Mann, 83 AD3d 793 (2nd Dept. 2011). The defendant correctly argues that its moving papers, which include the complaint in the underlying action, the judgment entered against GRINrx and the subject policy, conclusively establish the defenses of lack of standing and failure to state a cause of action. See Bronxville Knolls, Inc. v Webster Town Center Partnership, 221 AD2d at 248 (1st Dept. 1995); see 511 West 232nd Owners Corp v. Jennifer Realty Co., 98 NY2d 144 (2002); Blonder & Co., Inc v Citibank, N.A., 28 AD3d 180 (1st Dept. 2006). Therefore, and for the reasons stated above, the complaint is also subject to dismissal under CPLR 3211(a)(1).

(4) Cross-Motion for Summary Judgment; CPLR 3212

The granting of the defendant's motion to dismiss renders moot the plaintiffs' cross-motion for summary judgment. In any event, the plaintiffs have not demonstrated entitlement to that relief. The proponent of a motion for summary judgment pursuant to CPLR 3212 must establish its entitlement to such relief as a matter of law (see Zuckerman v City of New York, 49 NY2d 557 [1980]) by submitting proof in admissible form demonstrating the absence of triable issues of fact. See Alvarez v. Prospect Hospital, 68 NY2d 320 (1986); Winegrad v New York Univ. Med. Ctr., 64 NY2d 851 (1985). Since they fail to state a cognizable claim against the defendant insurer under Insurance Law § 3420, as discussed herein, the plaintiff cannot be granted summary judgment in their favor on that complaint.

CONCLUSION

The defendant's motion to dismiss is granted, and the plaintiffs' cross-motion for summary judgment is denied.

Accordingly, it is:

ORDERED that the defendant's motion to dismiss the complaint is granted; and it is further,

ORDERED that the plaintiffs' motion for summary judgment is denied, and it is further,

ORDERED that the Clerk shall enter judgment dismissing the complaint in its entirety.

This constitutes the Decision and Order of the court.

Dated: September 29, 2014

, JSC

HON. NANCY M. BANNON
J.S.C.