Warshaw v Mendelow
2011 NY Slip Op 33972(U)
December 13, 2011
Supreme Court, New York County
Docket Number: 652173/2010
Judge: Paul G. Feinman
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SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: HON. PAUL G. FEINMAN

PART 12

Index Number : 652173/2010
LARRY WARSHAW AND CAROL
vs
MENDELOW, STEVEN
Sequence Number : 002
DISMISS

INDEX NO. 652173/2010E
MOTION DATE
MOTION SEQ. NO. 002
MOTION CAL. NO.

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

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	
Answering Affidavits — Exhibits	
Replying Affidavits	

Cross-Motion: ☐ Yes ☒ No

Upon the foregoing papers, it is ordered that this motion

MOTION IS DECIDED IN ACCORDANCE WITH THE ANNEXED DECISION AND ORDER.

PC 2/1/12 2:15PM

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

Dated: DEC 13 2011 ______ J.S.C.

Check one: ☐ FINAL DISPOSITION ☒ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

☐ SUBMIT ORDER/ JUDG. ☐ SETTLE ORDER/ JUDG.

[* 2]

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: CIVIL TERM: PART 12

---X

LARRY WARSHAW and CAROL WARSHAW as TRUSTEES for CAROL ANN ENTERPRISES, INC. PENSION PLAN, and SAJUST, LLC,
Plaintiffs,

-against-

STEVEN MENDELOW, KONIGSBERG, WOLF & CO., and PAUL KONIGSBERG,
Defendants.

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Index No. 652173/2010

Mot. Seq. No. 002

DECISION & ORDER

APPEARANCES:

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Papers considered on review of this motion to dismiss:

PAPERS	E-FILING DOCUMENT NO.
First Amended Complaint	15
Notice of Motion to Dismiss First Amended Complaint, Affs., Exhibits	22, 22-1 through 22-5
Memorandum of Law in Support, Aff. of Service	23, 24
Aff. in Opposition, Exhibits, Memorandum of Law in Opposition	27, 27-1 through 27-4, 26
Reply Memorandum of Law in Further Support	30
Sur-Reply Aff. in Opposition, Exhibit	38
Sur-Reply Aff. in Further Support, Exhibits	39, 39-1, 39-2
Transcript of Oral Argument	40

PAUL G. FEINMAN, J.:

In the wake of Bernard Madoff's (Madoff) $65 billion Ponzi scheme, plaintiffs Larry Warshaw and Carol Warshaw, trustees for Carol Ann Enterprises, Inc. Pension Plan (Carol Ann),

a pension plan for a business owned by plaintiff Larry Warshaw and his family, and Sajust, LLC (Sajust), a New York limited liability company owned by the Warshaw family (collectively, plaintiffs), are seeking to hold defendants liable for losses of more than $2.6 million invested into Bernard L. Madoff Investment Securities, LLC (BLMIS) through FGLS Equity, LLC (FGLS), an investment vehicle allegedly incorporated by defendants in March 2003 to funnel money into BLMIS. Defendant Steven Mendelow (Mendelow) and his wife, Nancy Mendelow, served as operating members of FGLS. The website for defendant Konigsberg, Wolf & Co. (KW), a mid-sized certified public accounting firm in Manhattan, listed Mendelow as its only principal. Mendelow has been a principal at KW since 1982.

Defendants KW and Paul Konigsberg (Konigsberg), the head and senior tax partner of KW (collectively, the Konigsberg defendants), here move to dismiss plaintiffs' first amended complaint (the complaint), pursuant to CPLR 3211 (a) (7), for failure to state a cause of action. Plaintiffs amended their complaint on February 17, 2011, asserting five causes of action against defendants: (1) accounting malpractice (as against Mendelow and KW); (2) breach of fiduciary duty (as against Mendelow and KW); (3) fraud and conspiracy to defraud (as against all defendants); (4) negligent misrepresentation (as against Mendelow and KW); and (5) aiding and abetting fraud (as against all defendants). The causes of action incorporate by reference all preceding allegations in the complaint.

The claims asserted by plaintiffs involve the following general allegations: plaintiffs claim that KW, through Mendelow and other accountants that worked at the firm, as their financial advisor, defrauded them with respect to their investment in FGLS and BLMIS. First, defendants fraudulently induced them to invest in BLMIS by making material and false

representations. Plaintiffs specifically allege that defendants intentionally misrepresented to plaintiffs: (1) that FGLS and BLMIS would be wise investments; and (2) that they would present no risk of loss.

Plaintiffs claim that at the time these misrepresentations were made, defendants knew (or should have known) about Madoff's fraudulent investment scheme. Upon hearing defendants' financial advice, Carol Ann's trustees reasonably relied upon the recommendations of its trusted advisors, invested in FGLS, which in turn, invested all of the pension plan's assets in BLMIS. Defendants also induced plaintiffs to reinvest in BLMIS and keep their assets there in the long run. The complaint avers that defendants served and advanced their own personal interests to the detriment of Carol Ann. It further alleges that defendants failed to safeguard their assets, neglected to independently verify the investment reports of BLMIS, and ignored evidence of BLMIS's fraudulent conduct. The complaint also alleges that the Konigsberg defendants and Mendelow knowingly played a role in Madoff's multibillion-dollar Ponzi scheme. Despite overwhelming "red flags" that Madoff's trading results were implausible and likely fraudulent, defendants allegedly recruited investors for BLMIS, concealed the Ponzi scheme through the provision of accounting and tax preparation services to Madoff and other investors, and unlawfully profited from kickbacks. As a result, Carol Ann lost over $2.6 million dollars, and it now seeks compensatory damages of at least $2,676,434.

Although Mendelow has separately moved to dismiss, that motion is scheduled for oral argument in January 2012.[1] For the reasons more fully expressed below, defendants Konigsberg,

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[1] Irving H. Picard, Esq., trustee for the consolidated Securities Investor Protection Act liquidation of Bernard L. Madoff Securities, LLC and Bernard L. Madoff, has filed a $20 million fraudulent conveyance action against Mendelow related to his alleged receipt of kickbacks from Madoff (*see Picard, Trustee for the Liquidation of*

Wolf & Co. and Paul Konigsberg's instant motion to dismiss the first amended complaint is denied in its entirety.

Background

Larry Warshaw is a Florida resident and Carol Warshaw is a New Jersey resident, who each serve as trustees of Carol Ann. Larry Warshaw was also the operating manager of Sajust during the relevant time periods. Konigsberg, a certified public accountant and attorney, is one of the founders and president of KW. Mendelow, a trained accountant, served as KW's "engagement partner" and his biography on the KW website stated that he "specializes in unique transactions, wealth building and generational matters, and financial restructuring (*see* http://www.konigsbergcpa.com)."[2] At the time that defendants were urging plaintiffs to invest in BLMIS, Mendelow already had been sanctioned by the Securities Exchange Commission (SEC) for originating $89 million in funds for Madoff, by selling unregistered securities through Telfran Associates Ltd. (Telfran), an unregistered securities firm, and Avellino & Bienes (A & B), another accounting firm. Mendelow, through his control of Telfran, sold notes to investors with a promised annual return rate of approximately 15%. Telfran used investors' funds to purchase notes with a higher promised return rate from the closely affiliated A & B, who in return, received a fixed return rate from BLMIS. Mendelow allegedly received in excess of five million dollars in fraudulent side payments from Madoff. Konigsberg allegedly looked the other way

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BLMIS v Mendelow, Adv Pro No. 10-ap-04823 [BRL] [Bankr SD NY filed November 30, 2010]. Mendelow has filed a motion in Bankruptcy Court for the Southern District of New York to enforce an automatic stay under Section 362 of the United States Bankruptcy Code and the stay order of the District Court, and to enjoin this action as against him under Section 105 of the Bankruptcy Code. In response to this law suit, Mendelow has asserted his Fifth Amendment right against self-incrimination.

[2] Shortly after the filing of the initial complaint in this action, KW removed its website.

when Mendelow was sanctioned by the SEC. He also received a guaranteed rate of return of 17% on his own BLMIS investment. Mendelow is no longer a certified public accountant.

Madoff was a prominent member of the investing community, serving as a member of the NASDAQ stock market's Board of Governors and as vice-chairman of the National Association of Securities Dealers. Madoff's investment company, BLMIS, had operated since 1960. BLMIS reputedly ran the world's largest hedge fund, and functioned both as investment manager and custodian of securities. Konigsberg served as accountant for the Madoff Family Foundation and signed the federal tax form 990 for the foundation from 1998 through 2007. During the same time period, Konigsberg prepared Madoff's personal tax returns related to his interest in foreign financial accounts.

Madoff claimed he could provide consistently high return rates on investments into his fund because he employed a "split-strike conversion strategy." The investment strategy involved buying a basket, or group, of 35 to 50 stocks listed on Standard & Poor's 100 index and using options to hedge against losses. When funds were not invested in the basket of stocks and options, funds were allegedly invested in money market funds and United States Treasury bills to insure the safety of investments. As the public has since come to learn, Madoff never purchased or sold any securities. Instead, Madoff forged paper account statements and daily trade ticket confirmation trading records. The money he took from investors was used, in part, to pay for his lavish lifestyle. As is true of all Ponzi schemes, Madoff also used the investments of new and existing customers to fund withdrawals of principal and supposed profit made by other customers.

Madoff periodically wired hundreds of millions of dollars into BLMIS's affiliate, Madoff

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Securities International Limited (MSIL), a London-based entity. MSIL was owned by Madoff, his wife, their two sons and Konigsberg. Investors received fabricated monthly or quarterly statements showing that securities were held in, or had been traded through, their accounts. Despite many years of success, the precipitous downturn in the economy and the stock market collapse caused Madoff's scheme to unravel in late 2008. On December 11, 2008, Madoff was arrested by federal authorities for operating a multi-billion dollar Ponzi scheme for nearly twenty years. Madoff pleaded guilty to securities fraud and related offenses on March 12, 2009, and was subsequently sentenced to 150 years in prison. According to the complaint, a number of entities closely related to Mendelow made significant withdrawals from FGLS before Madoff's arrest.

The complaint contends that defendants allegedly exploited the trust that Larry Warshaw had developed as the result of KW serving as a long-time financial advisor, tax preparer and accountant for him and his family businesses. Plaintiffs' initial business arrangements for tax advice and accounting services were with KW, and not simply with Mendelow individually. As time went on, plaintiffs placed greater trust in KW and began to rely upon KW to provide tax planning and investment services. KW was paid a monthly rate for accounting, tax and investment services.

As outlined in Larry Warshaw's affidavit, during the time period that plaintiffs invested in FGLS, Steve Hagler (Hagler) was the primary accountant whom KW assigned to provide accounting and tax preparation services to plaintiffs. Alfred Pruskowski (Pruskowski) later replaced Hagler as the KW accountant. Both Hagler and Pruskowski handled accounting work for Carol Ann under Mendelow's supervision. In June 2005, KW and Mendelow allegedly advised Larry Warshaw to amend Carol Ann's incorporation documents in order to facilitate its

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investments into FGLS. FGLS operated out of the offices of KW. Shortly thereafter, with KW's guidance, the pension plan documents were amended, and investments in FGLS were made between August 2005 and December 2008. Additionally, upon the advice of KW, as communicated principally by Mendelow, Warshaw and his family formed Sajust for the purpose of investing in FGLS. KW again structured the transaction. Sajust made the first of several investments in FGLS between 2003 and December 2008.

The wrongs alleged include that defendants misrepresented what Carol Ann and Sajust were investing in, the safety and suitability of the investment for plaintiffs, and what the role of Mendelow and KW would be in managing the investment. Hagler, Pruskowski and Mendelow allegedly informed Larry Warshaw that FGLS and BLMIS were safe investments that consistently generated positive returns. Larry Warshaw was also told that the accounting firm's wealthier clients had invested successfully with BLMIS. Warshaw claims that he relied on KW's representation regarding Mendelow's sophistication and experience as an investment and business advisor.

Defendants allegedly concealed the true nature of their relationship with Madoff. To further effectuate and conceal their agreement to defraud plaintiffs, the complaint alleges that defendants also arranged for Mendelow to serve as the managing member of FGLS, and for KW to prepare the tax returns and provide accounting services for FGLS, instead of hiring independent accountants as required by FGLS' Operating Agreement. Mendelow was required to maintain "complete and accurate books of account, in which shall be entered, fully and accurately, each and every transaction of the company" and "in accordance with sound accounting practices and principles applied in a consistent manner" (*see Defs. Notice of Motion*,

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exhibit 2, FGLS Operating Agreement, at 12). Under the FGLS Operating Agreement, Mendelow was furnished with all rights and powers necessary to "maximize Company profits." Nonetheless, all of FGLS' capital was invested with BLMIS.

The complaint contends that the representations by KW and Mendelow regarding the legitimacy and low level of risk of plaintiffs' investment in BLMIS, through FGLS, were false and misleading. Additionally, it is alleged that Mendelow and KW falsely assured plaintiffs that they would continue to monitor their investments in FGLS and BLMIS. The complaint also alleges that defendants failed to make certain disclosures, and that defendants intended to deceive plaintiffs by withholding material information about FGLS and BLMIS. Specifically, no independent accountant was ever hired to review FGLS' trade tickets and monthly statements. BLMIS sent to KW a bundle of trade ticket confirmations for its investors "once a month, sometimes not at all." These trade confirmations were allegedly discarded by KW because it only needed to rely on the monthly statements for its tax preparation work. According to the complaint, FGLS' books and records do not contain any trade confirmations relating to BLMIS' fictious securities trades. The complaint insists that a review of trade confirmations by an independent auditor would have revealed fraudulent transactions occurring outside of the actual daily trading range or on days that the stock markets were closed. Further, even though FGLS' monthly statements shown substantial investments in Fidelity Brokerage Services, LLC's Fidelity Spartan U.S. Treasury Money Market Fund, this money market fund was not offered during the time investments were made to FGLS. R.J. Speranza, the head of KW's tax department, and other employees allegedly raised concerns related to BLMIS' year-end statements, the implausibility of high returns in a down market, and the legitimacy of BLMIS' operations.

However, the Konigsberg defendants purportedly shut their eyes to these concerns.

According to the complaint, defendants' actual knowledge of BLMIS' fraud is evidenced by their knowledge of serious warning signs and their alleged profiting from the relationship with Madoff. Plaintiffs allege that defendants knew that BLMIS's management, compliance and audit responsibilities were undertaken by Madoff's brother, two sons, niece and other unqualified individuals. Paul Konigsberg retained Mendelow despite knowledge of his participation in another Madoff scheme. He also promoted Mendelow to KW's customers as a principal and expert financial advisor. Thus, the complaint alleges that Konigsberg lent "respectability to Mendelow" and provided Mendelow with the support of his firm from which he could solicit investments.

Mendelow allegedly received lucrative side payments from Madoff based on the number of investors he solicited to invest in BLMIS. He also arranged for BLMIS accounts to be opened for himself and family members with a guaranteed rate of return ranging from 28% to 43% per year. Konigsberg is alleged to have been a major fund-raiser for BLMIS, and he was enriched by Madoff for recruiting new investors. As the sole owner of KW, Konigsberg profited from fees KW earned from its Madoff-related work since Madoff often referred his account holders to KW for tax preparation and accounting services. Besides referring clients, the complaint maintains that Madoff allegedly relied on defendants to conceal his scheme. The Konigsberg defendants shielded Madoff from discovery by handling the tax and accounting work for hundreds of investors who supposedly received annual returns of 10% to 17% with BLMIS. Paul Konigsberg personally prepared the tax returns for some of Madoff's closest long-term investors which concealed the referral relationship with BLMIS as the true source of income. Specifically, he

prepared the tax returns for Norman Levy (Levy), one of Madoff's closest friends who allegedly received returns of 100% in a year, disguised as a kickback for referring other clients. The complaint further avers that KW had a separate department to handle the tax and accounting work related to Levy's financing of the Madoff scheme. The department was in a locked room that was sealed off from the rest of the firm. Levy allegedly transferred $83 billion in and out of BLMIS from 1998 through 2001, and withdrew $305 million more than he invested from BLMIS. The complaint also asserts that Konigsberg directed BLMIS to pay his son approximately $22,500 on an annual basis, which was calculated as a percentage of investments of certain clients that Konigsberg referred to BLMIS in the early 1990s.

According to the complaint, KW acted as an intermediary between Madoff and other investors, and the firm handled withdrawals and advances to Madoff accounts on behalf of these investors and sent them false performance data regarding their investments on a monthly basis. In addition to their professional relationship, Konigsberg and Madoff had a personal relationship. Along with Madoff and another KW client, Konigsberg participated as an investor in improperly claiming a $22 million tax deduction from the donation of a California property to charity. These facts were never disclosed to plaintiffs. A number of entities controlled by, or closely affiliated with, Paul Konigsberg were allegedly "net winners" in Madoff's Ponzi scheme, including KW's pesnion plan and SDK Investors, an entity that Konigsberg formed and owned, which was closed out in 2005, three years before the scheme collapsed, with a profit of $1.6 million.

Sajust and Carol Ann allegedly lost $2,676,434 in principal. Carol Ann lost at least $894,590.93 based on investments made in FGLS beginning in August 2005, and Sajust lost at least $1,781,843.48 based on investments made in FGLS beginning in the summer of 2003.

Discussion

Standard for Determination of Motion to Dismiss

When evaluating a motion to dismiss pursuant to CPLR 3211 (a) (7), a court must consider all material factual allegations as true and draw all reasonable inferences in favor of plaintiff (*see EBC I, Inc. v Goldman, Sachs & Co.*, 5 NY3d 11 [2005]; *Sokoloff v Harriman Estates Dev. Corp.*, 96 NY2d 409 [2001]). The court will deny the motion "if from the pleadings' four corners, factual allegations are discerned which taken together manifest any cause of action cognizable at law" (*511 W. 232nd Owners Corp. v Jennifer Realty Co.*, 98 NY2d 144, 152 [2002] [internal quotation marks and citations omitted]). "The test on a motion to dismiss for insufficiency of the pleadings is not whether the plaintiff has artfully drafted the complaint but whether, deeming the complaint to allege whatever can be reasonably implied from its statements, a cause of action can be sustained" (*Pepler v Coyne*, 33 AD3d 434, 435 [1st Dept 2006], quoting *Stendig, Inc. v Thom Rock Realty Co.*, 163 AD2d 46, 48 [1st Dept 1990]).

As a preliminary matter, the court examines the motion by the Konigsberg defendants seeking a dismissal of the claims asserted against them in their individual capacity. Plaintiffs allege that Mendelow's wrongful acts were performed during the scope of his employment with KW and that his knowledge is attributable to the Konigsberg defendants. In opposition, the Konigsberg defendants argue that they cannot be held personally liable for Mendelow's alleged wrong-doing because he was acting outside the scope of his employment with KW and for his own personal gain when he committed the torts alleged in the complaint. Specifically, the Konigsberg defendants argue that all of Mendelow's actions were done in his role of operating member of FGLS, not in his role as a KW accountant or agent. Consequently, the Konigsberg

defendants insist that they have no primary liability. At this stage of the litigation, however, the court rejects the contention by the Konigsberg defendants that liability against them is precluded.

It is undisputed that Mendelow was authorized to handle accounting services to plaintiffs and was, in fact, the designated KW person assigned to communicate with plaintiffs. Whether the Konigsberg defendants may be held liable for the alleged causes of actions turns on whether Mendelow had a principal-agent relationship with them.

Under the doctrine of respondeat superior or vicarious liability, liability for tortious acts of an employee may generally be imposed upon the employer if the employee was acting within the scope of his employment (*see Judith M. v Sisters of Charity Hosp.*, 93 NY2d 932 [1999]; *Cornell v State of New York*, 46 NY2d 1032 [1979]; *see also Bowman v State of New York*, 10 AD3d 315, 316 [1st Dept 2004] ["[a]n employer may be vicariously liable for its employees' tortious acts on the theory of respondeat superior only if they were committed in furtherance of the employer's business and within the scope of employment"]). Acts are within the scope of employment for purposes of vicarious liability if they further the interests of the employer in some way, and are not done solely to benefit the employee (*see Koam Produce, Inc. v DiMare Homestead, Inc.*, 213 F Supp 2d 314, 325 [SD NY 2002], *affd* 329 F3d 123 [2d Cir 2003]).

The doctrine of imputation ascribes liability for malfeasance to a corporation and its agents under the principle that a corporate officer is aware of and responsible for the actions of his agent, except for an "adverse interest" exception where the corporate officer was found to be acting in his own interests (*see Center v Hampton Affiliates*, 66 NY2d 782, 784 [1985]; *Christopher S. v Douglaston Club*, 275 AD2d 768 [2d Dept 2000).

A corporation is charged with knowledge of all material facts of which its agent acquires

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knowledge while acting in the course of his employment and within the scope of his employment (*Valley Assoc. Corp. v Rogers*, 4 Misc 2d 382 [Sup Ct, Westchester County 1956]).

> "So long as the agent acts within the scope of his employment in good faith, for the interest of his principal, he is presumed to have disclosed to his principal all the facts that come to his knowledge as agent; but just as soon as the agent forms the purpose of dealing with his principal's property for his own benefit and advantage ... he ceases, in fact, to be an agent acting in good faith for the interest of his principal, and his action thereafter based upon such purpose is deemed to be in fraud of the rights of his principal, and the presumption that he has disclosed all the facts that have come to his knowledge no longer prevails."

Benedict v Arnoux, 154 NY 715, 728 [1898]; *see also Brooklyn Distilling Co. v Standard Distilling & Distributing Co.*, 193 NY 551 [1908]).

A corporation, must by necessity, act through its agents (*see Kirschner v KPMG, LLP*, 15 NY3d 446, 465 [2010] [discussing general principles of agency and corporations]). An agency relationship exists under New York law when there is an agreement between the principal and the agent that the agent will act for the principal, and the principal retains a degree of control over the agent (*see In re Parmalat Securities Litigation*, 594 F Supp 2d 444, 451 [SD NY 2009], *affd Pappas v Bank of America Corp.*, 309 Fed Appx 536 [2d Cir], *cert denied Smith v Bank of American Corp.*, 130 S Ct 95 [2009]; *see also William Stevens Ltd. v Kings Village Corp.*, 234 AD2d 287, 288 [2d Dept 1996]). When the existence of an agency relationship is uncertain, the courts often look to control as a critical indicator.

To bind a principal, an agent must have authority, whether apparent, actual or implied (*see e.g. Merrill Lynch Interfunding Inc. v Argenti*, 155 F3d 113, 122 [2d Cir 1998]). Actual authority arises from a principal's direct manifestations to the agent (*In re Parmalat Securities Litigation*, 594 F Supp 2d 444, *supra*). "It 'may be express or implied, but in either case it exists only where the agent may reasonably infer from the words or conduct of the principal that the

principal has consented to the agent's performance of a particular act'" (*id.* at 452 [internal quotations and citations omitted]).

The Konigsberg defendants contend that Mendelow's actual authority did not extend to providing investment advice to plaintiffs and fraudulently inducing plaintiffs to invest in FGLS and BLMIS. The question remains whether Mendelow was cloaked with apparent authority so that plaintiffs could have reasonably relied upon his authority to invest in both FGLS and BLMIS.

The court recognizes that "[t]he mere creation of an agency for some purpose does not automatically invest the agent with 'apparent authority' to bind the principal without limitation" (*Ford v Unity Hospital*, 32 NY2d 464, 472 [1973][internal citation omitted]). Under New York law, apparent authority is only created through "'words or conduct of the principal communicated to a third party'" such that a third party can reasonably rely on the "appearance and belief that the agent possesses authority to enter into a transaction'" (*Standard Funding Corp. v Levitt*, 89 NY2d 546, 551 [1997], quoting *Hallock v State of New York*, 64 NY2d 224, 231 [1984]).

The court rejects the Konigsberg defendants' argument that *Kirschner v KPMG, LLP* (15 NY3d 446, *supra*) requires dismissal of the claims against them. Ruling on certified questions submitted by two courts in two cases, the New York Court of Appeals in *Kirschner*, in a close 4-3 decision, held that accountants who allegedly should have detected malfeasance by executives of Refco and American International Group, Inc. could not be sued under state law. The Court held that the principles under which the actions were dismissed, in pari delicto and imputation, are embedded in New York law and remain sound. The Court reinforced the rule in New York

that "all corporate acts including fraudulent ones" are presumptively imputed to the corporation and its principals (*id.* at 466). The Court stressed that a principal must be "responsible for the acts of its authorized agents even if particular acts were unauthorized," because "the risk of loss from the unauthorized acts of a dishonest agent falls on the principal that selected the agent" (*id.* at 465 [internal quotation marks and citation omitted]). Further, "[a] principal is liable for the fraudulent acts of his agent committed within the scope of his authority, and if the agent acted outside the scope of his authority, the principal is nevertheless liable if he later ratifies the fraudulent acts and retains the benefits derived from them" (*Adler v Helman*, 169 AD2d 925, 926 [3d Dept 1991], citing *Chase Manhattan Bank N.A. v Perla*, 65 AD2d 207, 211 [4th Dept 1978]). "'When an agent abandons the object of his agency and acts for himself, by committing a fraud for his own exclusive benefit, he ceases to act within the scope of his employment and, to that extent, ceases to act as agent'" (*Adler v Helman*, 169 AD2d at 926, quoting *Credit Alliance Corp. v Sheridan Theatre Co.*, 241 NY 216, 220 [1925]).

Lastly, a corporate officer may be liable for torts committed by or for the benefit of the corporation if the officer participated in their commission (*see Aguirre v Paul*, 54 AD3d 302, 304 [2d Dept 2008]; *Greenway Plaza Off. Park v Metro Constr. Servs.*, 4 AD3d 328, 329-330 [2d Dept 2004]).

Articulating what acts fall within the scope of employment so that vicarious liability attaches is difficult to define. However, determining whether or not certain acts fall within the scope of employment is "normally left to the trier of fact" (*Schilt v New York City Tr. Auth.*, 304 AD2d 189, 193 [1st Dept 2003]).

"The determination of whether the doctrine applies depends upon '[t]he

> connection between the time, place and occasion for the act; the history of the relationship between employer and employee as spelled out in actual practice; whether the act is one commonly done by such an employee; the extent of departure from normal methods of performance; and whether the specific act was one that the employer could reasonably have anticipated.'"

Ramos v Jake Realty Co., 21 AD3d 744, 745 [1st Dept 2005], quoting *Riviello v Waldron*, 47 NY2d 297, 303 [1979]; *see also Yuco Mgt., Inc. v Cheung*, 2010 WL 3728212, 2010 NY Misc LEXIS 4487 [Sup Ct, NY County 2010]).

Here, the complaint alleges that after Konigsberg learned of Mendelow's financial misconduct, he permitted Mendelow to hold himself out to the world and the accounting firm's employees as principal for KW. Plaintiffs allege that in advising them to invest in FGLS and BLMIS, Mendelow was acting as an agent of KW and in furtherance of KW's business. Critically relevant to the appearance of Mendelow's apparent authority is the location of FGLS's office in the same physical location as KW. Mendelow allegedly did FGLS work out of his KW office; used his KW e-mail address to communicate with plaintiffs; and was assigned by KW to assist plaintiffs and to supervise the KW accountants who did accounting work for plaintiffs. Plaintiffs further allege that they considered Mendelow's services as services performed by a member of KW on behalf of that firm. Given this background, the court finds that the first amended complaint, "liberally construed" in favor of plaintiffs, alleges sufficient facts to hold the Konigsberg defendants liable for the wrongs of Mendelow under either a respondent superior or agency theory. Indeed, as stated in the complaint, the former head of KW's Tax Department previously testified that Mendelow's role at the firm was to act as "a pitchman who sold things for the benefit of himself and the firm." According to his testimony, Mendelow once stated "we make money the old fashioned way - we sell things and get paid for it."

In sum, corporations and corporate officers cannot insulate themselves from liability merely by contending that their agents or employees were not authorized to commit illegal acts, and, thus, any such acts are not imputable to the corporation. Accordingly, the Konigsberg defendants' motion which seeks to dismiss the causes of action against them as individuals must be denied.

The Causes of Action

1. Accounting Malpractice

Plaintiffs first claim that Mendelow and KW are liable for professional malpractice. In order to allege accounting malpractice, a plaintiff must plead that the defendant departed from recognized and accepted professional standards of practice for accountants and that this departure proximately caused his injury (*see Friedman v Anderson*, 23 AD3d 163 [1st Dept 2005]; *see also Kristina Denise Enterprises v Arnold*, 41 AD3d 788 [2d Dept 2007]). "'To establish a prima facie case of proximate cause, a plaintiff must show that the defendant's negligence was a substantial cause of the events which produced the injury'" (*Maheshwari v New York*, 2 NY3d 288, 295 [2004], quoting *Derdiarian v Felix Contr. Corp.*, 51 NY2d 308, 315 [1980]; *see also In re Parmalat Securities Litigation*, 501 F Supp 2d 560, *supra*).

The Konigsberg defendants argue that the accounting malpractice claim fails against KW because the complaint contains no allegations that it violated any professional standard, that it was the proximate cause of the injury alleged by plaintiffs, or that plaintiffs suffered any cognizable injury from its actions. According to this logic, KW was simply plaintiffs' accountant and tax preparer.

According to plaintiffs, KW and Mendelow failed to exercise independence and due

professional care required by industry practices. The practice of accounting, as with other professions, has become increasingly specialized. In *Friedman v Anderson*, the Appellate Division, First Department, recently stated:

> "Accountants have a duty to perform within the scope of their professional accounting standards, which generally go beyond simple auditing and bookkeeping. Further, the type of financial management and planning advice that [the accountant] gave to [his client] is widely recognized throughout the accounting profession to be part of the typical services rendered by professional accountants. In other words, imparting financial advice regarding client investments is an integral part of accounting today."

(*Friedman v Anderson*, 23 AD3d at 165).

In this case, plaintiffs have come forward with allegations establishing a prima facie case of accounting malpractice. Defendants were allegedly employed to provide investment services, and they implicitly promised to provide those services in a professional manner. Mendelow presented himself on KW's website as an expert in providing investment advice. He should, therefore, be held to a standard of care that is consistent with that representation. Nonetheless, KW employees, including Mendelow, allegedly made inaccurate representations about the soundness of the investment vehicle and failed to warn plaintiffs of suspicious circumstances, including implausible returns, the sending of paper trade confirmations once a month instead of real-time electronic notifications and avoidance of SEC reporting requirements, which were known to them (*see 1136 Tenants Corp. v Max Rothenberg & Company*, 36 AD2d 804 [1ST Dept 1971], *affd* 30 NY2d 585 [1972] [accounting firm retained to perform unaudited services committed professional malpractice by ignoring suspicious circumstances and failing to inform client of missing invoices]). With respect to defendants' alleged failure to reveal a conflict of interest, the record demonstrates that defendants benefitted from the purported failure to disclose

this information, and that this failure to disclose was a causative factor in the injury sustained by plaintiffs. Based on these allegations, plaintiffs have adequately alleged a claim of accounting malpractice against Mendelow and KW.

2. Breach of Fiduciary Duty

The second cause of action is based on a breach of fiduciary duty in failing to provide honest and competent investment advice and failing to act in plaintiffs' best interests. In order to establish a breach of fiduciary duty in New York, a plaintiff must show the existence of a fiduciary relationship, misconduct that induced the plaintiff to engage in the transaction in question, and damages directly caused by that misconduct (*see Barrett v Freifeld*, 64 AD3d 736, 739 [2nd Dept 2009]). "A fiduciary relationship arises 'between two persons when one of them is under a duty to act for or to give advice for the benefit of another upon matters within the scope of the relation'" (*Eurycleia Partners, LP v. Seward & Kissel, LLP*, 12 NY3d 553, 561 [2009], quoting *EBC I v Goldman Sachs & Co.*, 5 NY3d at 19. "It is said that the relationship exists in all cases in which influence has been acquired and abused, in which confidence has been reposed and betrayed" (*Penato v George*, 52 AD2d 939, 942 [2d Dept 1976]).

While a fiduciary relationship may exist where one party reposes confidence in another, and reasonably relies on the other's superior expertise or knowledge, a relationship between an accountant and his client usually does not give rise to a fiduciary duty (*see DG Liquidation, Inc. v Anchin, Block & Anchin, LLP*, 300 AD2d 70 [1st Dept 2002]). New York courts, however, have held that a determination of whether a special fiduciary relationship exists is highly fact-specific and typically not resolvable at the pleading stage (*see e.g. Knight Securities, LP v Fiduciary Trust Co.*, 5 AD3d 172 [1st Dept 2004]).

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Both sides disagree about whether their relationship was fiduciary in nature. The Konigsberg defendants argue that the cause of action for breach of fiduciary duty fails, because the complaint contains no allegations supporting the inference that KW owed any fiduciary duty to plaintiffs, much less that it breached that duty. Moreover, they maintain that, in advising plaintiffs, Mendelow was acting in his individual capacity as the operating member of FGLS, and not as a principal of KW.

Under certain limited circumstances, a fiduciary duty may arise between an accountant and his client, where the plaintiff claims the accountant withheld some knowledge with the intent to deceive, with the resultant harm and fraud. In *Nate B & Frances Spingold Foundation v Wallin, Simon, Black & Co.* (184 AD2d 464 [1st Dept 1992]), the Appellate Division, First Department, held that a claim for breach of fiduciary duty against an accountant is actionable "where the allegations include knowledge and concealment of illegal acts and diversions of funds" (*id.* at 465-466; *see also Lavin v Kaufman, Greenhut, Lebowitz & Forman*, 226 AD2d 107 [1st Dept 1996] [allegations that defendant knowingly misrepresented or failed to disclose information to plaintiff sufficient to state a cause of action for breach of fiduciary duty against accountants]; *Kanev v Turk*, 187 AD2d 395 [1st Dept 1992] [accountant's advice to plaintiff to make unsecured loan where accountant allegedly knew of borrower's insolvency stated a cause of action for breach of fiduciary duty]).

Whether a relationship is fiduciary in nature must also be determined on the basis of the services agreed to by the parties (*see Northeast Gen. Corp. v Wellington Adver.*, 82 NY2d 158 [1993]). Here, no written agreement has been produced defining the precise scope of defendants' services. Nonetheless, plaintiffs urge the court to hold that KW and Mendelow are fiduciaries

because they provided investment services to Carol Ann.

In support of their position, plaintiffs cite to *Leber v Konigsberg* (2010 WL 5067549, 2010 US Dist LEXIS 128910 [SD Fla 2010]), which the court finds persuasive, but not controlling. In that case, Steven Leber, as grantor and trustee of a family trust, filed a lawsuit against Konigsberg and his accounting firm, charging breach of fiduciary duty and professional malpractice related to a Madoff account opened by him in 1998. The complaint alleged that Konigsberg solicited and facilitated the investment by the trust of all its assets with Madoff, that Konigsberg represented to Leber that he would personally supervise and provide due diligence as to the trust's account with Madoff, and that he would provide advisory services to the trust. Defendant sought summary judgment on plaintiff's breach of fiduciary duty claim. He argued that accountants owe clients a fiduciary duty only when the accountant engages in fraud or illegal acts. The federal court disagreed. The court, while applying New York law, denied the motion, premising its determination on the parties' long-term relationships, as well as Konigsberg's role in rendering complex investment advice and supervision of assets. In effect, the court recognized that the relationship between the parties was not strictly "an ordinary accountant-client relationship" and that accountants owe a fiduciary duty when they provide investment advisory services (*Leber v Konigsberg*, 2010 WL 5067549, *3, 2010 US Dist LEXIS 128910, *9). As a consequence, the court further recognized that there were factual issues as to whether the parties entered into a fiduciary relationship that precluded summary judgment.

Based on the allegations in the present complaint, the court concludes that plaintiffs have come forward with evidence from which a reasonable fact-finder could find that a fiduciary relationship existed between the parties. Professionals such as investment advisors, who owe

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fiduciary duties to their clients, "may be subject to tort liability for failure to exercise reasonable care, irrespective of their contractual duties," since in "these instances, it is policy, not the parties' contract, that gives rise to a duty of care" (*Sommer v Federal Signal Corp.*, 79 NY2d 540, 551-552 [1992]; *see also Bullmore v Ernst & Young Cayman Islands*, 45 AD3d 461 [1st Dept 2007] [professional investment advisor had fiduciary duty to client in connection with hedge fund collapse notwithstanding whether a contractual duty exists]).

In this case, the complaint alleges that, like in *Leber*, plaintiffs, as trustees of Carol Ann, had a close, long-term relationship with Mendelow and KW. As well, defendants allegedly did more than merely perform basic accounting functions. Mendelow and KW invited plaintiffs to accept their investment advice, in reliance on their professional skills. As a result, they were authorized to perform a variety of investment services for plaintiffs, which included amending the pension plan, planning and structuring Sajust in a manner that would be useful in effectuating KW's investment advice, and soliciting plaintiffs to invest with FGLS and BLMIS. Mendelow had complete discretion over their assets. Pursuant to their alleged fiduciary duty, defendants had a duty to disclose any material information related to its investment advice. All these allegations are sufficient to establish a fiduciary relationship (*see Dickerman v Northern Trust Co.*, 176 US 181, 203-204 [1900]; *Roni LLC v Arfa*, 74 AD3d 442 [1st Dept), *affd* 15 NY3d 826 [2010]).

Breach of fiduciary cases require that a cause of action against a defendant allege facts which implicate defendant's honesty, loyalty and duty of care to those whose interests are to be protected (*see e.g. Birnbaum v Birnbaum*, 73 NY2d 461 [1989]). The allegations in the present case clearly assert dishonesty, bad faith and disloyalty on the part of defendants.

Under plaintiffs' theory, KW and Mendelow provided tax, financial and investment advice to Carol Ann and Sajust, and in reliance upon that advice, plaintiffs' corporate and pension plan assets were invested in a now worthless investment. Based both on the parties' investment advisor-client relationship and on KW's status as the organizer of Sajust, defendants had a duty to use due diligence and to act reasonably when making investments on behalf of plaintiffs. The complaint sufficiently alleges that defendants abandoned their fiduciary duty as financial advisors when they fraudulently misrepresented the safety of FGLS and BLMIS.

A fiduciary may not have interests adverse to those of the client, and where a conflict of interest exists, nothing less than full and complete disclosure is required of the fiduciary (*Guice v Charles Schwab & Co.*, 89 NY2d 31, 45 [1996], *cert denied* 520 US 1118 [1997] [court ruled that if dual interests are to be served, disclosure, to be effective, must lay bare the truth, without ambiguity or reservation, in all its stark significance]; *TPL Associates v Helmsley-Spear, Inc.*, 146 AD2d 468 [1st Dept 1989]). Thus, within the context of a financial advisor-client relationship, plaintiffs' claims that Mendelow and KW were acting in their own self interest, and that they failed to fully disclose the extent and nature of their relationship with Madoff, are sufficient to support a cause of action for breach of fiduciary duty.

Konigsberg, as the managing member of KW, cannot escape the imposition of a duty of care, which is imputed to him. Despite the existence of suspicious circumstances, indicating the possibility of fraud, KW and Mendelow breached their fiduciary duties to plaintiffs when they solicited plaintiffs to invest in FGLS and BLMIS, and then turned over Carol Ann's and Sajust's assets to FGLS and BLMIS. Defendants also failed to disclose the conflict of interest that existed between them and the investment vehicle that they were promoting for plaintiffs, and the

failure to disclose a conflict of interest is one of those circumstances that may give rise to a breach of fiduciary duty claim. The allegations underlying plaintiffs' fiduciary duty claim also are based partly on defendants' failure to monitor their investments as they were obligated to do as plaintiffs' investment advisor. Instead of putting plaintiffs' interest first, KW and Mendelow allegedly only worked to advance their own interests, contrary to their fiduciary duties. Under these circumstances, the breach of fiduciary duty will not be dismissed against the two defendants.

3. Fraud

The Konigsberg defendants first argue that the fraud cause of action is deficient because it fails to plead the necessary elements of the claim. Next, defendants argue that plaintiffs have failed to plead the alleged fraudulent conduct with the required specificity of CPLR 3016 (b).

The elements of a cause of action for fraud are a material misrepresentation of a fact, knowledge of its falsity, an intent to induce reliance, justifiable reliance by the plaintiff and damages (*see Lama Holding Company v Smith Barney, Inc.*, 88 NY2d 413 [1996]; *Friedman v Anderson*, 23 AD3d 163 [1st Dept 2005]). Thus, the gist of fraud is cunning, deception and artifice to cheat another, to the other's injury. "A claim rooted in fraud must [also] be pleaded with the requisite particularity under CPLR 3016 (b)" (*Eurycleia Partners, LP v Seward & Kissel, LLP*, 12 NY3d at 559 [citation omitted]). The New York State Court of Appeals, however, has cautioned that this statute "should not be so strictly interpreted as to prevent an otherwise valid cause of action in situations where it may be impossible to state in detail the circumstances constituting a fraud" (*Pludeman v Northern Leasing Sys., Inc.*, 10 NY3d 486, 491 [2008][internal quotation marks and citation omitted]). "[C]orporate officers and directors may

be held individually liable if they participated in or had knowledge of the fraud, even if they did not stand to gain personally" (*Polonetsky v Better Homes Depot*, 97 NY2d 46, 55 [2001]).

Under New York law, the element of scienter is adequately alleged if "the complaint contains some rational basis for inferring that the alleged misrepresentation was knowingly made" (*Houbigant, Inc. v Deloitte & Touche LLP*, 303 AD2d 92, 98 [1st Dept 2003]). Scienter requires plaintiffs to plead "specific facts from which it is possible to infer defendant's knowledge of the falsity of its statements." (*id.* at 99). In *Houbigant*, accountants had written a private letter identifying certain "reportable conditions" to the client. These same accountants had certified to the public that the client's financial statements were accurate although those financial statements did not detail the "reportable conditions" the accountants had previously identified (*id.* at 95). Further, a plaintiff can support an inference of fraud by pleading reckless disregard or blindness to the true facts of the client's financial condition (*see Westpac Banking Corp. v Deschamps*, 66 NY2d 16, 18 [1985]).

Gross negligence or recklessness can take the place of actual knowledge under New York law (*see State Street Co. v Ernst*, 278 NY 104, 112 [1938] ["A refusal to see the obvious, a failure to investigate the doubtful, if sufficiently gross, may furnish evidence leading to an inference of fraud so as to impose liability for losses suffered by those who rely on the balance sheet."]; *accord*, *Ultramares Corp. v Touche*, 255 NY 170, 179 [1931] ["Fraud includes the pretense of knowledge when knowledge there is none"]). Gross negligence is the failure to exercise even "slight care" or "slight diligence" (*Gentile v Garden City Alarm*, 147 AD2d 124, 131 [2d Dept 1989]). It is conduct that is so careless as to show complete disregard for the rights and safety of others (*id.*).

"Under New York law, 'an injury is proximately caused if it is the natural and probable consequence of the defrauder's misrepresentation or if the defrauder ought reasonably to have foreseen that the injury was a probable consequence of his fraud'" (*Citibank, N.A. v K-H Corp.*, 968 F2d 1489, 1496 [2d Cir 1992], quoting *Cumberland Oil Corp. v Thropp*, 791 F2d 1037, 1044 [2d Cir], *cert denied* 479 US 950 [1986]). New York courts have long recognized investors' right to sue for false statements inducing them to retain their investments (*see e.g. Hotaling v A.B. Leach & Co.*, 247 NY 84, 93 [1928] ["As long as the fraud continued to operate and to induce the continued holding of the bond, all loss flowing naturally from that fraud may be regarded as its proximate result"]; *Stern Bros. v New York Edison Co.*, 251 App Div 379,381 [1st Dept 1937] ["Fraud which induces non-action where action would have otherwise have been taken is as culpable as fraud which induces action which would have otherwise been withheld"]; *Continental Ins. Co. v Mercadante*, 222 App Div 181 [1st Dept 1927]).

In this case, plaintiffs have alleged a sufficient causal connection between defendants' wrong-doing and plaintiffs' harm. As well, the complaint and accompanying affidavit are sufficient to withstand scrutiny under CPLR 3016 (b) insofar as they allege fraud against the KW defendants. As alleged by plaintiffs, the fraud in this case was part of a scheme that took place over many years. The complaint alleges more than errors of judgment or incompetence on the part of the defendants. Rather it alleges a series of facts, which, if proven to be true, demonstrate deception, self-dealing and fraud on the part of defendants. It also pleads with particularity sufficient to place the defendants on notice that their representations as to the quality of the investments are the subject of this claim, and the nature of the information the claim contends that defendants fraudulently concealed. Plaintiffs' complaint specifies the alleged fraudulent

statements made by Mendelow, the relationship between the various defendants, and the role allegedly played by each (*see Kaufman v Cohen*, 307 AD2d 113, 120 (1st Dept 2003] ["plaintiff need only provide sufficient detail to inform defendants of the substance of the claims"] [internal quotation marks and citation omitted]).

To satisfy the first element, defendants' false statements must be representations of present fact (*see Deerfield Communications* Corp. *v Chesebrough-Ponds, Inc.*, 68 NY2d 954 [1986]). Typically, statements of prediction or opinions about future performance cannot give rise to a fraud claim *(see ESBE Holdings, Inc. v Vanquish Acquisition Partners*, 50 AD3d 397, 398 [1st Dept 2008]). All the same, in *CPC International Inc. v McKesson Corp.* (70 NY2d 268 [1987]), the New York Court of Appeals recognized that financial projections of a company's future performance that are alleged to be false, unreasonable and not based on the company's actual financial condition can constitute the basis of a claim for fraud (*see also East 32nd Street Assocs. v Jones Lang Wooten USA*, 191 AD2d 68, 71 [1st Dept 1993]).

Mendelow, the sole principal of KW, recommended that plaintiffs invest Carol Ann's and Sajust's assets in both FGLS and BLMIS, and allegedly represented that these two investment vehicles were low-risk, high-yield and suitable for plaintiffs. He allegedly represented that Madoff generated consistently positive returns through the use of "state of the art computer programs" to "arbitrage" the purchase and sale of securities (*see* First Amended Complaint, at 23). He also falsely created the impression that he was managing FGLS' assets. He allegedly made these representations with the intent that plaintiffs rely on them. However, he knew or should have known that they were false. KW and Konigsberg allegedly concealed from plaintiffs defendants' extraction of payments from Madoff in exchange for covering up the Ponzi scheme.

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The complaint further alleges that plaintiffs relied on Mendelow's self-proclaimed expertise in investing, and invested over $2.6 million dollars in funds that were unsafe and unsuitable for plaintiffs' pension plan. The complaint also sufficiently alleges that plaintiffs continued to rely on the representations made by KW accountants in continuing to invest in FGLS after plaintiffs' initial investment.

Plaintiffs have also satisfied the second element of the fraud claim, that defendants knew that their statements were false. The complaint sufficiently alleges that defendants had access to information that contradicted their public statements to plaintiffs. The complaint persuasively alleges that some KW employees had doubts about investing with Madoff. The complaint contends that defendants knew that Madoff's BLMIS's returns were impossible. KW's handling of the Levy account, in particular, circumstantially demonstrates that the Konigsberg defendants were aware of Madoff's fraudulent scheme and were participating in propping it up. Additionally, the complaint sufficiently alleges that Mendelow's knowledge and complicity in the alleged misrepresentations, as well as his active participation in the way FGLS and BLMIS were promoted are evidence from which a reasonable jury could conclude that defendants were involved in conscious misbehavior or recklessness. Fortified with this information and other "red flags" alleged in the complaint, Mendelow did nothing but deliver money from plaintiffs to Madoff. Moreover, the complaint sufficiently alleges that defendants benefitted in a concrete way from the purported fraud. KW, Konigsberg and Mendelow earned lucrative fees from plaintiffs' investments with FGLS and BLMIS. Defendants allegedly knew that Madoff fabricated extraordinary returns for certain investors. Under these circumstances, plaintiffs argue that their claim sufficiently alleges defendants' gross negligence, recklessness and conscious

disregard for their legal obligations to them. Plaintiffs' fraud claim concludes by alleging that plaintiffs lost more than $2.6 million because of their reliance on defendants. Based on these facts, the complaint states a cause of action sounding in fraud (*see Davis v CCF Capital Corp.*, 277 AD2d 342 [2d Dept 2000]).

While plaintiffs' allegations of fraud against Paul Konigsberg are not stated in the complaint in the same detail as they are against Mendelow, the circumstantial inference of Konigsberg's fraudulent conduct is sufficient (*see Oster v Kirschner* (77 AD3d 51, 55-56 [1st Dept 2010]). Konigsberg was a high-ranking senior officer of KW and Mendelow's supervisor (*see Chaikovska v Ernst & Young, LLP*, 78 AD3d 1661, 1663 [4th Dept 2010] [Cheikovska was CEO, and knowledge of the fraud was imputed to him]). Additionally, a party not in privity in contract with a plaintiff may be held liable for his individual acts of fraud (*see Cherry v Resource Am.*, 285 AD2d 989, 991 [4th Dept 2001]), and "a corporate officer may be held personally liable for committing fraud on the corporation's behalf" (*see First Bank of Americas v Motor Car Funding, Inc.*, 257 AD2d 287, 294 [1st Dept 1999]; *see also I. Towjer, Inc. v Tarran*, 236 AD2d 518, 519 [2d Dept 1997]). If there was a fraudulent scheme, Konigsberg's knowledge of it and participation in it are clear, because it would have been impossible for Mendelow to carry out the fraudulent scheme as alleged without Konigsberg knowing of the scheme and participating in it. Mendelow was also acting as KW's agent, and KW prominently displayed Mendelow's expertise as a financial consultant on its website.

It bears noting that the fraud action is viable even though some of the alleged acts and misrepresentations were mentioned in connection with the negligent misrepresentation and accounting malpractice claims (*see Serio v PricewaterhouseCoopers LLP*, 9 AD3d 330, 331 [1st

Dept 2004], citing *Houbigant, Inc. v Deloitte & Touche*, 303 AD2d 92, 95 [1st Dept 2003]). For these stated reasons, the Konigsberg defendants' motion to dismiss the fraud cause of action is denied.

4. Negligent Misrepresentation

"A claim for negligent misrepresentation requires the plaintiff to demonstrate (1) the existence of a special or privity-like relationship imposing a duty on the defendant to impart correct information to the plaintiff; (2) that the information was incorrect; and (3) reasonable reliance on the information" (*J.A.O. Acquisition Corp. v Stavitsky*, 8 NY3d 144, 148 [2007]; *see also Parrott v Coopers & Lybrand*, 95 NY2d 479 [2000]). A plaintiff may recover for negligent misrepresentation "only where there is a special relationship of trust or confidence, which creates a duty for one party to impart correct information to another .... The special relationship requires a closer degree of trust than that in an ordinary business relationship" (*Wright v Selle*, 27 AD3d 1065, 1066-1067 [4th Dept 2006] [internal quotations and citations omitted]).

As previously found by the court, plaintiffs have sufficiently alleged that they had a "special relationship" with defendants at the time that the alleged statements inducing the investments were made. Plaintiffs also rely on the fact that KW and Mendelow had special expertise in offering investment advice (*see Kimmell v Schaefer*, 89 NY2d 257, 264 [1996]). This is a similar argument made with respect to the fraud cause of action and, in fact, the courts have recognized that "the tort of negligent misrepresentation involves most of the same elements as fraud, with a negligence standard substituted for the scienter requirement" (*Mia Shoes, Inc. v Republic Factors Corp.*, 1997 WL 525401, *3, 1997 US Dist LEXIS 12571, *6 [SD NY 1997]; *Ambassador Factors v Kandel & Co.*, 215 AD2d 305 [1st Dept 1995]).

The Konigsberg defendants contend that plaintiffs make only blanket allegations of misstatements allegedly made by KW and Mendelow. They argue that the complaint fails to allege that these defendants made specific misstatements, only that Mendelow's misstatements should somehow be attributed to KW.

Notwithstanding defendants' arguments, plaintiffs' negligent misrepresentation claim is more than sufficient to put Mendelow and KW on notice of the claim against them. There are two alleged categories of misrepresentations found in the complaint: (1) misrepresentations made initially to plaintiffs to induce them to invest in FGLS and BLMIS; and (2) misrepresentations, in the form of periodic updates, about BLMIS's performance that were made to motivate plaintiffs to retain their investments in FGLS and BLMIS. Specifically, the complaint alleges that Mendelow represented that BLMIS provided a safe investment and that KW and Mendelow had performed and continued to perform due diligence regarding Madoff's operation. KW also provided plaintiffs with monthly statements falsely reflecting that BLMIS consistently generated positive returns. According to the complaint, KW knowingly distributed this false performance data to plaintiffs to induce their continuing investments in FGLS and BLMIS. In issuing these reports, the complaint alleges that KW concealed from plaintiffs its extensive knowledge of irregularities in BLMIS's operations. The disclosure of these irregularities would have been viewed by the reasonable investor as material, since that person might have considered them important in the making of an investment decision. As a result of all these allegations, the court concludes that the claim of negligent misrepresentation against KW and Mendelow may proceed.

5. Aiding and Abetting Fraud

While the Konigsberg defendants are not disputing the existence of the Madoff fraud or

that Mendelow actively promoted FGLS and BLMIS, they argue that the complaint is devoid of allegations that the two of them substantially assisted Mendelow in defrauding plaintiffs. As well, the Konigsberg defendants contend that the special pleading requirements of CPLR 3016 (b) have not been met for the aiding and abetting fraud cause of action, and, therefore, the cause of action must be dismissed against them. Again, the court disagrees.

A claim for aiding and abetting a fraud allows imposition of liability on those who would not be liable on the fraud claim, but who had actual knowledge of the fraud and substantially assisted it (*see 380544 Canada, Inc. v Aspen Technology, Inc.*, 544 F Supp 2d 199 [SD NY 2008]). To establish liability for aiding and abetting fraud, plaintiffs must show: (1) the existence of a fraud; (2) defendant's knowledge of the fraud; and (3) that defendant provided substantial assistance to advance the fraud (*see Franco v English*, 210 AD2d 630, 633 [3d Dept 1994] [requiring nexus between the primary fraud, defendant's knowledge of the fraud and what it did with the intention of advancing the fraud's commission]). "Substantial assistance exists where (1) a defendant affirmatively assists, helps conceal, or by virtue of failing to act when required to do so enables the fraud to proceed, and (2) the actions of the aider/abettor proximately caused the harm on which the primary liability is predicated" (*Stanfield Offshore Leveraged Assets, Ltd. v Metropolitan Life Insurance Co.*, 64 AD3d 472, 476 [1st Dept 2009] [internal citations and quotations omitted]; *see also Houbigant, Inc. v Deloitte & Touche LLP*, 303 AD2d at 100).

In *Oster v Kirschner* (77 AD3d at 55-56), the Appellate Division, First Department, broadly construed the "actual knowledge" element of an aiding-and-abetting cause of action against lawyers, holding that plaintiffs may be able to sufficiently allege "actual knowledge" by

inferring it from the surrounding circumstances, such as the nature of objectionable client conduct known to the lawyer at the time legal services are rendered, and the nature of the legal services rendered. Actual knowledge need only be pleaded generally, particularly at the pre-discovery stage, because a plaintiff lacks access to the very discovery materials which would illuminate a defendant's state of mind (*Oster v Kirschner*, 77 AD3d at 55).

The same fraud allegations adequately support the aiding and abetting fraud cause of action (*see Semi-Tech Litigation, LLC v Ting*, 13 AD3d 185, 187 [1st Dept 2004]; *Knight Securities LP v Fiduciary Trust Co.*, 5 AD3d at 173-174; *Houbigant, Inc. v Deloitte & Touche LLP*, 303 AD2d at 100). The complaint alleges that defendants substantially assisted Madoff in a continuing course of conduct to induce investors and to conceal adverse material information about Madoff's wrong-doing. Plaintiffs' allegations that, among other things, defendants helped amend the structure of the subject pension fund to invest in FGLS and BLMIS, helped develop Sajust to invest in FGLS, and affirmatively concealed Madoff's scheme by fraudulently preparing tax returns for certain investors and conducting annual audits of FGLS, constitute, in part, the substantial assistance necessary to state a cause of action for aiding and abetting fraud.

Plaintiffs also sufficiently allege that defendants had actual knowledge of the fraud perpetrated by Madoff (*see Oster v Kirschner*, 77 AD3d at 55). While the Konigsberg defendants attempt to shift responsibility to Mendelow, the complaint alleges that these defendants, along with Mendelow, hid their self-dealing from plaintiffs to enhance the profits made from engaging with Madoff. Moreover, the complaint alleges that defendants were reckless and grossly negligent in failing to disclose numerous obvious irregularities to plaintiffs.

The complaint alleges that, as a result of defendants' conspiracy, each defendant should

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be held jointly and severally liable for plaintiffs' losses. However, the court agrees with defendants that "New York does not recognize an independent cause of action for civil conspiracy to commit a tort..." (*Roche v Claverack Co-op Ins. Co.*, 59 AD3d 914, 918 [3rd Dept 2009]). "[A] mere conspiracy to commit a fraud is never of itself a cause of action" (*Brackett v Griswold*, 112 NY 454, 467 [1889]). Nonetheless, "allegations of conspiracy are permitted ... to connect the actions of separate defendants with an otherwise actionable tort" (*Alexander & Alexander of New York, Inc. v Fritzen*, 68 NY2d 968, 969 [1986]). As an actionable tort has been alleged, the aiding and abetting fraud cause of action does not fail against any defendant.

Conclusion

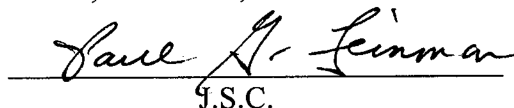
For the reasons set forth above, the complaint alleges facts sufficient to state claims for accounting malpractice, breach of fiduciary duty, fraud, negligent misrepresentation and aiding and abetting fraud. Accordingly, it is hereby

ORDERED that defendants Paul Konigsberg's and KW's motion to dismiss the first amended complaint, pursuant to CPLR 3211 (a) (7), is denied in its entirety; and it is further

ORDERED that defendants are directed to serve an answer to the first amended complaint within 20 days after service of a copy of this order with notice of entry and to upload a copy of said answer into the NYSCEFS; and it is further

ORDERED that the parties shall appear for a preliminary conference on February 1, 2012 at 2:15 p.m. in Part 12, 60 Centre Street, Room 212, New York, NY 10007.

Dated: December 13, 2011



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