UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In re J. EZRA MERKIN AND BDO SEIDMAN SECURITIES LITIGATION	No. 08 Civ. 10922 (DAB)
CROSCILL INC., et al., Plaintiffs, -against- GABRIEL CAPITAL, L.P. et al., Defendants.	No. 09 Civ. 6031 (DAB)
MORRIS FUCHS HOLDINGS, LLC Plaintiff, -against- GABRIEL CAPITAL, L.P. et al., Defendants.	No. 09 Civ. 6483 (DAB)

REPLY MEMORANDUM OF LAW
IN SUPPORT OF DEFENDANTS J. EZRA MERKIN AND
GABRIEL CAPITAL CORPORATION'S MOTION TO DISMISS

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Preliminary Statement

Defendants J. Ezra Merkin and Gabriel Capital Corporation respectfully submit this reply memorandum of law in further support of Defendants' Motion to Dismiss the Third Consolidated Amended Class Action Complaint.[1]

The Opening Brief demonstrated that Plaintiffs' claims for violation of Section 10(b) of the Exchange Act and common law fraud should be dismissed because the TAC fails to identify an actionable misrepresentation, fails to raise a strong inference of scienter, and fails to plead reasonable reliance or loss causation. Dismissal of the Section 10(b) claim in turn mandates dismissal of the claim for "control person" liability under Section 20(a) of the Exchange Act. The Opening Brief further explained that upon dismissal of the federal securities fraud claims, this Court should decline to exercise jurisdiction over Plaintiffs' state law claims, which should therefore be dismissed.

In opposition, Plaintiffs suggest that their claims should be permitted to proceed for the simple reason that the New York Attorney General sued Defendants in New York state court, and survived a motion to dismiss, based on the same conduct that gives rise to the instant litigation, and two arbitration panels have awarded damages to investors who elected to bring individual arbitrations against Merkin. But the crux of the NYAG action is for violation of the Martin Act, which unlike Section 10(b) does not require scienter or reliance and does not require claims to be pled with specificity. Tellingly, despite an extensive pre-complaint investigation, which included a review of thousands of documents and depositions of Merkin and other

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[1] Unless otherwise noted, capitalized terms used herein have the same meaning as in the Memorandum of Law in Support of Defendants J. Ezra Merkin and Gabriel Capital Corporation's Motion to Dismiss, dated August 2, 2010 ("Opening Brief" or "Open. Br."). Plaintiffs Croscill and Fuchs, whose separate actions have been coordinated with the class action, joined in Lead Plaintiffs' briefing except with respect to their individual breach of contract claims, which are addressed in Point II(I) *infra*. Moreover, Croscill does not dispute that its federal securities claims are barred by the statute of limitations and should be dismissed for that additional reason. (*See* Open. Br. at 11 n.5.)

employees of GCC, the NYAG did not allege a fraud claim.[2] Similarly, in the *Wiederhorn* arbitration, claimant withdrew his Section 10(b) claim after completion of discovery, and the Panel unanimously rejected both his common law fraud claim and claim based on allegedly inadequate due diligence and monitoring of Madoff.[3] And in the *Sandalwood* arbitration, in an unreasoned decision, the Panel awarded claimants just 30% of the damages sought -- hardly suggestive of a finding of intentional misconduct or recklessness.

In any event, this Court should not simply defer to the more relaxed pleading standards, and lower substantive threshold, applicable to the state court and arbitration claims. Rather, this Court must consider Plaintiffs' claims against the exacting requirements of the PSLRA, Rule 9(b) and *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009).

As to the substance of their opposition, Plaintiffs group their allegations of purported misrepresentations in the Offering Memoranda into three categories -- (i) that Merkin allegedly "was involved in the management of each of the Funds on a day-to-day and transaction-by-transaction basis"; (ii) the "very specific" investment strategy of each of the Funds and use of "multiple" independent money managers; and (iii) that Merkin conducted due diligence on and monitored the third-party managers. As explained in the Opening Brief and below, these purported misrepresentations either do not appear in the Offering Memoranda or are not false.

Indeed, in their desperate attempt to save their claims, Plaintiffs persist in repeating allegations that they and their counsel know are wrong. For example, the Opening Brief

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2 Furthermore, the TAC's repeated references to the NYAG's Complaint -- untested and unadjudicated conclusions that are not entitled to a presumption of truth -- are improper and should be disregarded. *See Lipsky v. Commonwealth United Corp.*, 551 F.2d 887, 892-94 (2d Cir. 1976); *Shahzad v. H.J. Meyers & Co.*, No. 95 Civ. 6196 (DAB), 1997 WL 47817, at *13-14 (S.D.N.Y. Feb. 6, 1997).

3 Moreover, over a compelling dissent, the majority expressly awarded damages on an "equitable" basis. The panel unanimously found that Merkin did not engage in fraud and his due diligence was neither reckless nor grossly negligent.

demonstrated that nowhere does any Offering Memorandum state that Merkin manages any of the Funds on a "day-to-day" or "transaction-by-transaction" basis. Nevertheless, without citing to a single provision in any Offering Memorandum, Plaintiffs argue that the Offering Memoranda "falsely stated" that Merkin would do so. (Opp. Br. at 7.) Moreover, Plaintiffs do not dispute that Lead Plaintiff NYLS was told in November 2006 that at least a portion of Ascot was invested with Madoff. (*See* Open. Br. at 2). And Daniel Krasner, a senior partner of Co-Lead Counsel Wolf Haldenstein Adler Freeman & Herz LLP who is himself an investor in Ascot and member of the purported class, admitted to the NYAG that he too was aware prior to Madoff's confession that Ascot invested with Madoff.

Plaintiffs' arguments with respect to scienter are equally unavailing. Plaintiffs acknowledge that their only bases for asserting that Defendants acted with scienter are that (i) Defendants allegedly failed to conduct due diligence on Madoff and/or ignored red flags that they allegedly would have seen had they conducted sufficient due diligence, and (ii) Merkin earned substantial fees for managing the Funds, including on the Funds' investments with Madoff. Under well-established precedent in the Second Circuit and this District -- the sole exception being Judge Marrero's recent opinion in *Anwar v. Fairfield Greenwich Ltd.*, --- F. Supp. 2d ---, No. 09 Civ. 0118, 2010 WL 3341636 (S.D.N.Y. Aug. 18, 2010) -- neither allegation suffices to plead scienter. Furthermore, Plaintiffs' admission that Defendants fully disclosed all relevant information concerning the Funds' investments with Madoff to the Funds' auditor, BDO Seidman, LLP, fatally undermines any allegation of scienter.

Finally, as explained in the Opening Brief and below, in the event the Court exercises jurisdiction over the state law claims, those claims should be dismissed for several independent reasons: (i) they are preempted by SLUSA; (ii) Madoff's fraud was an intervening criminal

cause of Plaintiffs' injury, negating the requisite element of causation; (iii) the exculpatory provisions in the Funds' Governing Documents bar the breach of fiduciary duty, unjust enrichment, and negligent misrepresentation claims; and (iv) the TAC fails to state a claim with respect to each of the asserted state common law claims.

Argument

POINT I

THE TAC FAILS TO STATE A SECTION 10(b) CLAIM

A. The TAC Fails To Allege An Actionable Misrepresentation Or Omission

As illustrated in the Opening Brief, Plaintiffs' Section 10(b) claim fails because the Complaint does not allege a material misstatement or omission. (Open. Br. at 11-14.) Indeed, the cautionary language in the Funds' Offering Memoranda warned *exactly* of the risk that caused Plaintiffs' loss -- that third party managers would have custody over the Funds' assets and that such custody carried risk of loss, for which Merkin would not be liable. (Ascot OM at 17; Gabriel OM at 28; Ariel OM at 40-41.) Plaintiffs do not dispute this warning; nor do they dispute that the Offering Memoranda expressly permitted Defendants to delegate investment discretion for all of each Fund's assets to third-party managers. Rather, Plaintiffs argue that notwithstanding such warnings, Defendants misrepresented: (i) Merkin's role; (ii) the Funds' strategies; and (iii) the due diligence and monitoring that would be performed on third-party managers. Where, as here, the plain language of the offering document contradicts the misstatement or omission allegations, the court bears no obligation to "accept as true the allegations of the complaint." *See Barnum v. Millbrook Care Ltd. P'ship*, 850 F. Supp. 1227, 1232-33 (S.D.N.Y.), *aff'd*, 43 F.3d 1458 (2d Cir. 1994). Accordingly, as detailed below, Plaintiffs' arguments fall flat and their Section 10(b) claim should be dismissed.

1. Alleged Misrepresentations As To Merkin's Role

In arguing that the TAC alleges an actionable misrepresentation regarding Merkin's role in managing the Funds, Plaintiffs quote selectively, and thus misleadingly, from the Funds' Offering Memoranda. For example, Plaintiffs quote the Offering Memoranda's disclosure that "the Partnership's success depends to a great degree on the skill and experience of Mr. Merkin." (Opp. Br. at 15.) From this, Plaintiffs assert that Merkin falsely promised to manage the Funds on a "day-to-day" and "transaction-by-transaction" basis -- words and promises that simply do not appear in any of the Offering Memoranda.

To the contrary, the Offering Memoranda are replete with detailed disclosures that put the roles of Defendants and third-party managers into context -- disclosures that Plaintiffs simply ignore in the TAC and the Opposition Brief. Thus, immediately following the disclosure concerning the Fund's dependence on the general partner, the Ascot Offering Memorandum expressly disclose the risks of the Funds' investing with independent money managers and advise that "the success of the Partnership may also be dependent upon other money managers or investment advisors to Other Investment Entities" and that "the actions or inactions on the part of other money managers . . . may affect the profitability of the Partnership." (Ascot OM at 17; *see also* Gabriel OM at 28; Ariel OM at 40-41) ("Independent Money Managers").) The Offering Memoranda further warned that Merkin could delegate investment discretion to third-party managers without notice to or the consent of any investor in the Funds, and that when he delegated such authority he did not have responsibility for the "*investment decisions of any independent money managers*." (Ascot OM at 2; Gabriel OM at 2; Ariel OM at 2 (emphasis added).)

Plaintiffs' argument that these disclosures were somehow insufficient or misleading because they used the term "may" even though the delegation to Madoff had already occurred is

wrong. But the very first paragraph of the Offering Memoranda advised that the Funds "will make investments through third-party managers using managed accounts . . . ." (Ascot OM at 1; Gabriel OM at (i); Ariel OM at (i).) In any event, Courts uniformly recognize that it is appropriate to use the term "may" in risk disclosures, including to describe risks that were then occurring. *See Steinberg v. PRT Grp. Inc.*, 88 F. Supp. 2d 294, 310-11 (S.D.N.Y. 2000) (rejecting plaintiffs' argument that use of the future tense misleadingly implied that events were not currently occurring, and dismissing securities claims); *see also In re Thornburg Mortg., Inc., Secs. Litig.*, 695 F. Supp. 2d 1165, 1215 (D.N.M. Jan. 27, 2010) (finding statement that defendant "may" be subject to margin calls when it already was subject to margin calls not materially misleading); *In re RAC Mortg. Inv. Corp. Sec. Litig.*, 765 F. Supp. 860, 864 (D. Md. 1991) ("[T]he choice of verbs [can or shall] cannot be said to have been false or misleading. At best, plaintiffs are quibbling about semantics.").

In the face of these explicit disclosures, Plaintiffs cannot plausibly contend that they reasonably believed that Merkin was making every individual investment decision for all of the Funds himself. Where, as here, "the plaintiffs' claims of misleading disclosures are contradicted by disclosures made on the face of the prospectus, then no additional facts can prove the claims and dismissal is proper." *Hinerfeld v. United Auto Grp.*, No. 97 Civ. 3533, 1998 WL 397852, at *4 (S.D.N.Y. Jul. 15, 1998); *see also Olkey v. Hyperion 1999 Term Trust, Inc.*, 98 F.3d 2, 5 (2d Cir. 1996) ("It is undisputed that the prospectuses must be read 'as a whole.'").

2. Alleged Misrepresentations As To Funds' Strategies

Plaintiffs likewise fail to plead an actionable misrepresentation with respect to the description of the Funds' strategies. Plaintiffs concede that the Ascot Offering Memorandum's description of Ascot's primary strategy as "index arbitrage and options arbitrage" in which the Fund "purchases a portfolio of large-cap U.S. equities drawn from the S&P 100 . . . [and]

simultaneously purchases a put option and sells a call option on the S&P 100" (Ascot OM at 12) "was similar to the one that Madoff was purportedly following." (Opp. Br. at 20 n.16.) Indeed, that description is entirely accurate.

Plaintiffs nevertheless argue that the description is misleading because the strategy was Madoff's, not Ascot's, and because Ascot's assets "were concentrated in one investment with Madoff." (*Id.*) Plaintiffs' first argument is nonsensical: Whether individual trades were directed by Merkin or by Madoff, the strategy described in the Ascot OM was indisputably Ascot's strategy. Plaintiffs' second argument ignores the fundamental difference between investing in a hedge fund and owning a managed account at a brokerage firm where the broker has trading discretion. In the former, the investor owns an undivided interest in the fund itself while in the latter the investor directly owns each of the underlying securities in the account. Thus, Ascot did not have a single concentrated investment with Madoff; rather, until December 11, 2008, it believed that it owned the diverse basket of S&P 100 securities, hedged with index put and call options, held in its *fully disclosed* account with Madoff's SEC-regulated broker-dealer. (Ascot OM at 8 (describing Madoff as a principal prime broker and custodian for Ascot).) In any event, contrary to Plaintiffs' argument, the Ascot Offering Memorandum -- unlike the Gabriel and Ariel Offering Memoranda -- did not place any limit on the concentration of the Funds' investments.

With respect to the Gabriel and Ariel Funds, Plaintiffs similarly admit that the Offering Memoranda disclosed that those Funds would also engage in index arbitrage, including through third-party managers. Furthermore, the Offering Memoranda advised investors that Defendants could alter the Funds' investment strategies at any time. (Gabriel OM at 15; Ariel OM at 21.) Nor did the delegation to Madoff, even if viewed as a single investment (which, as explained above, it was not), violate the concentration limit imposed by the Gabriel and Ariel Offering

Memoranda. No more than 30% of Gabriel's and Ariel's assets were delegated to Madoff, well within the limit of the *greater* of 50% of each Funds' assets or 25% of each Funds' capital. Similarly, the expected risk associated with the Madoff investments, which was to be determined in Defendants' sole discretion (Gabriel OM at 15; Ariel OM at 21), never approached the limit of 10% risk to capital because the hedging through put options limited investment risk to 3-5% of the account balance, which was less than 2% risk to Gabriel's and Ariel's portfolios as a whole.

Finally, there is no merit to Plaintiffs' argument that the risk disclosures required Defendants to delegate investment discretion to "multiple" third-party managers to diversify and/or to limit risk. (Opp. Br. at 21.) The term "multiple" -- used repeatedly by Plaintiffs -- simply does not appear in the Independent Money Managers risk disclosure. Moreover, the use of singular versus plural in an offering document is immaterial as a matter of law. *See Bond Opportunity Fund v. Unilab Corp.*, No. 99 Civ. 11074, 2003 WL 21058251, at *6 (S.D.N.Y. May 9, 2003) (distinction between singular and plural immaterial because it would not "so alter the total mix of available information"), *aff'd*, 87 F. App'x. 772 (2d Cir. 2004).

3. Alleged Misrepresentations As To Due Diligence And Monitoring

Plaintiffs fail to allege facts to support their conclusory assertion that Defendants did not conduct due diligence and "blindly" delegated investment authority to Madoff. Rather, in their opposition brief, Plaintiffs cite to paragraphs in the TAC alleging that the SEC investigated Madoff at least three times (which, in light of the SEC's failure to take any enforcement action, supports rather than undermines Defendants' due diligence); that MarHEDGE and Barron's published articles about Madoff in 2001; that Harry Markopolos told the SEC in 2005 that Madoff could be running a Ponzi scheme, but did not make his suspicions public until after Madoff's confession; and that several other managers and investment advisers have claimed after-the-fact to have had suspicions about and refused to invest with Madoff (allegedly

including Swiss Bank UBP (Compl. ¶ 145),) which was by far the largest single investor in Ascot and twice sent teams of analysts with Merkin to visit Madoff and conduct their own due diligence). (Opp. Br. at 23 (citing Compl. ¶¶ 127-132; 135-155).)

As an initial matter, allegations regarding the level of Defendants' due diligence do not support a claim under Section 10(b). Indeed, the Second Circuit has made clear that the alleged failure to conduct due diligence does not give rise to a securities fraud claim. *See S. Cherry St., LLC v. Hennessee Grp. LLC*, 573 F.3d 98, 112-13 (2d Cir. 2009); *In re Beacon Assocs. Litig.*, --- F. Supp. 2d ---, No. 09 Civ. 777, 2010 WL 3895582, at *18 (S.D.N.Y. Oct. 5, 2010) ("[W]hen a business promises to conduct due diligence, but is incompetent or mismanaged and fails to uphold its promise, an aggrieved investor's remedy lies in a breach of contract action rather than a federal securities fraud action.") (citing *Mills v. Polar Molecular Corp.*, 12 F.3d 1170, 1176 (2d Cir. 1993)); *see also Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 474-80 (1977).

In any event, Plaintiffs' allegations, based almost exclusively on hindsight, do not plausibly suggest that Defendants failed to conduct due diligence or monitor Madoff. Rather, during the course of the Funds' nearly two-decade relationship with Madoff, he had until his confession an impeccable reputation on Wall Street, having served as Chairman of NASDAQ; testified regularly before Congress and the SEC on issues affecting the securities markets; and teamed with Goldman Sachs, Morgan Stanley, Merrill Lynch and Citigroup to form the first electronic exchange for NYSE stocks. *See* Creswell, Julie and Thomas, Landon Jr., *The Talented Mr. Madoff*, N.Y. Times, Jan. 25, 2009; *see also SEC v. Cohmad Secs. Corp.*, No. 09 Civ. 5680, 2010 WL 363844, at *5 (S.D.N.Y. Feb 2, 2010); ("In light of Madoff's established reputation as a successful and respected investment adviser, the high returns he produced were generally not perceived (even by professionals) as a badge of fraud."); *In re Beacon*, 2010 WL

3895582, at * 1; *In re Tremont Secs. Law, State Law and Ins. Litig.*, 703 F. Supp. 2d 362, 371 (S.D.N.Y. 2010). Moreover, Plaintiffs acknowledge that the Funds' auditor, BDO Seidman, was well-aware of the Funds' investments with Madoff and the returns purportedly being earned on those investments, was given access by Defendants and the Funds to the trading confirmations received from Madoff and knew the identity and size of Madoff's auditor. (*See* Plaintiffs' Opposition to the Motion of Defendant BDO Seidman LLP to Dismiss, pp. 7-8.) That BDO audited the Funds and, knowing these alleged shortcomings, nevertheless issued clean audit opinions year-after-year severely undermines Plaintiffs' securities fraud claims against Defendants. *See, e.g.*, *In re Winstar Commc'n*, No. 01 CV 3014, 01 CV 11522, 2006 WL 473885, at *8 (S.D.N.Y. Feb. 27, 2006) ("The good faith reliance on an accountant is a viable defense to scienter in securities fraud cases.") Especially in light of the failure of regulators, auditors and numerous other sophisticated investors to uncover Madoff's fraud before he confessed, Merkin's failure to detect Madoff's fraud does not plausibly suggest that he failed to conduct due diligence.

B. The TAC Does Not Plead Facts Giving Rise To A Strong Inference Of Scienter

The Opening Brief showed that the TAC does not allege facts to support an inference, much less a strong inference, that Defendants acted with scienter. (Open. Br. at 14-19.) Plaintiffs do not dispute that Defendants did not have actual knowledge of Madoff's fraud. Nor do they deny that Merkin and his family personally lost more than $100 million in the largest Ponzi scheme in history. Rather, they argue that the alleged failure to recognize the purported "red flags" associated with the Madoff investment was reckless and that Defendants' fees constituted sufficient motive for a fraud claim. Both arguments fail.

1. Plaintiffs Do Not Plead Conscious Misbehavior or Recklessness

To allege scienter based on Defendants' purported failure to conduct due diligence or disregard of "red flags," Plaintiffs must plead conduct that is "highly unreasonable" and that represents "an extreme departure from the standards of care." *Novak v. Kasaks*, 216 F.3d 300, 308 (2d Cir. 2000). Conclusory allegations that a defendant "'knew or [was] reckless in not knowing' [the true facts will] not satisfy [a plaintiff's pleading] requirements." *Shields v. Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1129 (2d Cir. 1994). The Opening Brief demonstrated that Plaintiffs do not meet this high standard. (Open. Br. at 14-19.)

Plaintiffs' arguments as to conscious misbehavior or recklessness focus on *post hoc* allegations of "red flags" that Defendants supposedly ignored. (*See* Opp. Br. at 25-29.) The Second Circuit, however, has explicitly rejected such allegations against an investment advisor that failed to uncover a Ponzi scheme as insufficient to establish scienter. *See S. Cherry*, 573 F.3d at 112 (affirming dismissal of Section 10(b) claim for failure to plead scienter because, *inter alia*, alleged disregard of purported red flags was at most negligent, not reckless).

Applying the principles articulated by the Second Circuit in *South Cherry*, the overwhelming majority of courts to consider Madoff-related allegations have found that the very same "red flags" that Plaintiffs allege here do not adequately plead scienter. *See In re Beacon*, 2010 WL 3895582, at *20 (applying *South Cherry* and holding that allegations that managers of fund that invested with Madoff failed to heed "red flags" did not support a finding of scienter);[4] *Newman v. Family Mgmt. Corp.*, --- F. Supp. 2d ---, No. 08 Civ. 11215, 2010 WL 4118083, at *8

[4] Plaintiffs' co-lead counsel Wolf Haldenstein is one of plaintiffs' counsel in *In re Beacon*, and is lead counsel in *Newman*. Judge Sand allowed the Section 10(b) claims to proceed against certain defendants in *In re Beacon* based on the separate allegation that the Beacon Offering Memorandum represented that the managers of Beacon had contracted with a third party to perform due diligence on Madoff when in fact that contract had been amended years earlier to eliminate any requirement that the third party perform due diligence on Madoff. Plaintiffs here do not, and cannot, make any remotely similarly allegation.

(S.D.N.Y. Oct 20, 2010) ("As this Court and other courts considering similar red flag allegations in the aftermath of the Madoff affair have found, Plaintiffs' allegations are insufficient to establish scienter.") (citing *In re Tremont Secs. Law, State Law and Ins. Litig.*, 703 F. Supp. 2d 362, 371 (S.D.N.Y. 2010)); *see also* Open Br. at 18-19 (citing authority).

In his well-reasoned opinion in *In re Beacon*, Judge Sand considered, analyzed and rejected as insufficient, alone or together, a laundry list of alleged red flags remarkably similar to those advanced by Plaintiffs here -- "Madoff's intense secretiveness; investors' inability to replicate Madoff's results using his claimed strategy; the low correlation of Madoff's performance to the market, despite the fact that his hedging strategy should have closely correlated to overall market performance; the suspiciousness of Madoff's claims to buy a security at its daily high and sell it at its daily low consistently; instances of Madoff's records reflecting a trade of a security at a price outside of the daily reported range for that security; the fact that an insufficient volume of options were traded on certain days to support Madoff's stated strategy; Madoff's decision to forego the standard hedge fund management fee of 1% plus 20% of profits and settle for commissions on trades, possibly to avoid heavier audit requirements; Madoff's stated practice of liquidating all securities at the end of each reporting quarter and investing the proceeds in treasury bills, ensuring that auditors could not verify the existence of Madoff securities for that period; Madoff's lack of a third-party custodian to hold BMIS's securities; Madoff's use of a small, unknown accounting firm; the fact that BMIS audits did not show any customer activity; the fact that key positions at BMIS were staffed by Madoff's family members; and Madoff's use of paper documentation of account activity and trades despite BMIS's supposed technological sophistication." 2010 WL 3895582, at *9. Nor, in Judge Sand's

opinion, did the MARHedge and Barron's articles,[5] combined with the other purported red flags, give rise to an inference of scienter. *See Newman*, 2010 WL 4118083, at *5, 8 (dismissing Section 10(b) claim against Madoff feeder fund manager for, *inter alia*, lack of scienter).

Plaintiffs simply ignore *Newman* and *In re Beacon*, and unconvincingly try to distinguish the other Madoff-related cases that have dismissed Section 10(b) claims premised on the same red flags alleged here.[6] Plaintiffs also argue in vain that *South Cherry* does not apply because in that case additional due diligence would not have uncovered Bayou's fraud whereas here it allegedly would have uncovered Madoff's fraud. But Judge McMahon's opinion in *Bayou*, affirmed by the Second Circuit in *South Cherry*, rejected that precise argument: "[F]ailure to discover the fraud merely places [defendants] alongside the SEC, the IRS, and [] other interested part[ies] that reviewed" and failed to detect the fraud.[7] *In re Bayou Hedge Fund Litig.*, 534 F. Supp. 2d 405, 418 (S.D.N.Y. 2007).

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5 The articles themselves illustrate that they are not the "red flags" Plaintiffs suggest. The MARHedge article acknowledged that "the four or five professionals [interviewed,] . . . express[ed] both an understanding of the [split-strike conversion] strategy and ha[d] little trouble accepting the reported returns it ha[d] generated." Michael Ocrant, "Madoff Tops Charts; Skeptics Ask How," MAR/Hedge (RIP), No. 89 May 2001, page 3. And the Barron's article describes Madoff as among the most-respected managers in the world. *See* Erin E. Arvedlund, *Don't Ask, Don't Tell,* Barrons, May 7, 2001.

6 Plaintiffs suggest that *Cohmad* is inapplicable because the defendants in that case did not manage a hedge fund but instead recommended individual clients to Madoff. That is a distinction without a difference. Indeed, unlike Merkin, the *Cohmad* defendants shared office space with Madoff and were paid a fee by Madoff for referring clients. Similarly, Plaintiffs' argument that *Meridian* and *In re Tremont* are inapplicable because those opinions involved claims against auditors is misplaced because the issue in those cases, like here, is whether the failure to note alleged red flags gave rise to an inference of scienter.

7 Plaintiffs' argument that the SEC has the discretion not to pursue an investigative target (Opp. Br. at 27, n.19) misses the point. The SEC did not decline to investigate Madoff or detect Madoff's fraud but decline to prosecute it. Rather, the SEC -- with its full range of investigative authority and subpoena power -- conducted at least three examinations and two investigations into Madoff's operation and failed to uncover Madoff's Ponzi scheme. In these circumstances, Defendants' inability to uncover the fraud despite doing due diligence is more than plausible. *See In re Tremont Sec.*, 703 F. Supp. at 371 ("[T]he more compelling inference as to why Madoff's fraud went undetected for two decades was his proficiency in covering up his scheme and eluding the SEC and other financial professionals.").

Against this overwhelming weight of authority, Plaintiffs rely almost exclusively on Judge Marrero's decision in *Anwar II*. While Judge Marrero no doubt concluded that alleged red flags concerning Madoff were sufficient at the pleading stage to allege scienter, Judge Marrero confronted specific factual allegations that Plaintiffs do not, and cannot, make here -- specifically, that defendants *actually* doubted Madoff's legitimacy, as expressed in their own contemporaneous emails, and that certain defendants engaged in "deliberately illegal behavior by attempting to stymie a Securities and Exchange Commission ('SEC') investigation into Madoff's operation." *See Anwar II*, 2010 WL 3341636, at *21-23. Notably, Judge Marrero concluded that the purported red flags similar to those alleged here were *insufficient* to plead scienter as to one defendant who had only *received* emails expressing doubts from others but had never expressed his own doubts. *See id.* at *23.

Here, too, there is no factual allegation that Defendants -- who, through the Funds, had more than $100 million invested with Madoff -- doubted Madoff. The most plausible inference is that Madoff duped Defendants the same way he "deceived countless investors and professionals, as well as his primary regulators, the Securities and Exchange Commission ("SEC") and the Financial Industry Regulatory Authority ("FINRA")." *In re Beacon*, 2010 WL 3895582, at *1. Hence, the allegations of the TAC are insufficient to show that Defendants acted with scienter.

2. Plaintiffs Do Not Plead Motive

Plaintiffs' argument that their fee allegations establish motive is frivolous. It is well-settled that allegations of defendants acting in their economic self-interest do not suffice to plead motive; rather, to plead motive, Plaintiffs must allege that Defendants had an incentive apart from the economic incentives of hedge fund managers. *Chill v. Gen. Elec. Co.*, 101 F.3d 263, 268 (2d Cir. 1996). Plaintiffs fall far short of that standard.

Plaintiffs assert, for example, that Merkin's fees were "exorbitant and unique" (Opp. Br. at 30), but do not allege facts to support that conclusory accusation. It is well-known that hedge funds typically charge up to a 2% management fee plus a 20% incentive fee. *See People v. Morris*, 28 Misc. 3d 1215(A), --- N.Y.S.2d ---, No. 0025/09, 2010 WL 2977151, at *15 (N.Y. Sup. Jul. 29, 2010) ("[M]anagers of Hedge and Private Equity funds commonly receive a 2% annual fee for assets under management and a 20% carried interest in profits."). Thus, Merkin's 1.5% management fee -- and no incentive fee -- for Ascot, and 1% management fee and 20% incentive fee for Gabriel and Ariel were well within, if not below, industry norms and do not give rise to an inference of scienter. *See Newman*, 2010 WL 4118083, at *7 (concluding that 1.4% management fee was not "exorbitant or at all in excess of the industry standard" and dismissing Section 10(b) claim against manager of hedge fund that indirectly invested with Madoff) (citing *ECA, Local 134 IBEW Joint Pension Trust of Chi. v. JP Morgan Chase Co.*, 553 F.3d 187, 198 (2d Cir. 2009)); *In re Beacon*, 2010 WL 3895582, at *13-14 (rejecting argument that receipt of significant management fees established motive for managers of hedge fund that invested with Madoff).[8]

Not surprisingly, Plaintiffs make no effort to explain how "one could plausibly infer" that Merkin would risk more than $100 million of his personal wealth by investing with someone he suspected of fraud in the hope "that Madoff would never get caught and Merkin simply wanted to make money while the scheme lasted." (Opp. Br. at 31.) That argument is patently absurd.

C. The TAC Does Not Allege Reasonable Reliance

The Opening Brief demonstrated that the Section 10(b) claim fails for the independent reason that Plaintiffs failed to allege reasonable reliance. Relying entirely on cases involving

[8] Even *Anwar II*, heavily relied on elsewhere by Plaintiffs, found that the substantial earnings of managers of a Madoff feeder fund did not constitute motive. *See Anwar II*, 2010 WL 3341636, at *21.

publicly traded securities and the fraud-on-the-market theory, where reliance is presumed, Plaintiffs argue that the TAC sufficiently pleads reliance. (Opp. Br. at 31-32.) However, where, as here, the securities at issue are not traded on an efficient market, Plaintiffs must allege reasonable or justifiable reliance. *See Harsco Corp. v. Segui*, 91 F.3d 337, 342 (2d Cir. 1996) (affirming dismissal of Section 10(b) claim because "[t]he fact of reliance . . . is not enough by itself; that reliance must be justifiable, or reasonable.") (citing *Harrison v. Dean Witter Reynolds, Inc.*, 79 F.3d 609, 618 (7th Cir.1996)); *San Diego Cnty. Emps. Ret. Ass'n v. Maounis*, --- F.Supp.2d ----, No. 07-2618 (DAB), 2010 WL 1010012, at *14 (S.D.N.Y. Mar. 15, 2010) (dismissing Section 10(b) claim because plaintiffs' reliance on alleged misrepresentations was "unreasonable as a matter of law").

The Offering Memoranda disclosed that Defendants would delegate investment authority to outside managers and had the authority to do so without notice to the Funds' investors. A plaintiff fails to plead reasonable reliance where, as here, "[a] review of the Offering Materials yields numerous examples of disclosures that directly contradict what Plaintiffs allege was misrepresented or omitted by Defendants." *Spain v. Deutsche Bank*, No. 08-10809, 2009 WL 3073349, at *3 (S.D.N.Y. Sept. 18, 2009); *see also supra* Point I(A). Hence, Plaintiffs could not have reasonably relied on the notion that Defendants alone would manage the Funds.

D. The TAC Fails to Plead Loss Causation

Because Plaintiffs' losses occurred as a direct result of Madoff's fraud and not of any action on the part of Defendants, Plaintiffs cannot establish loss causation. (Open. Br. at 27-28.) Nevertheless, Plaintiffs contend that they properly allege loss causation because Plaintiffs' losses resulted from Defendants' alleged failure to conduct due diligence and consequent failure to uncover Madoff's Ponzi scheme. (Opp. Br. at 33.) As explained above, however, the TAC is devoid of factual allegations to support the conclusory assertion that Defendants did not conduct

due diligence or that any additional due diligence would have detected Madoff's massive fraud. *See In re Bayou*, 534 F. Supp. 2d at 418. The loss causation requirement exists to protect defendants from becoming insurers against investment losses that are beyond their control, which Madoff's fraud plainly was. *See Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 345 (2005). That conclusion is particularly apt here since Plaintiffs were expressly warned of the very risk that caused their loss.

E. TAC Fails To State A Claim As To Investors In The Offshore Funds Because Section 10(b) Does Not Apply Extraterritorially

As explained in the Opening Brief, the Supreme Court's recent decision in *Morrison v. National Austl. Bank Ltd.* mandates dismissal of the Section 10(b) claims of investors in the offshore funds -- Ariel and Ascot Fund Limited ("Ascot Fund")[9] -- because those investors did not purchase any securities within the United States. (Open. Br. at 21-22.) Applying the presumption against extraterritoriality, *Morrison* held that Section 10(b) applies "only [to] transactions in securities listed on domestic exchanges, and domestic transactions in other securities." 130 S. Ct. 2869, 2884 (2010).

Plaintiffs nevertheless argue that because Plaintiffs Finkelstein and Nephrology are U.S. residents, and because Finkelstein and Nephrology wired money to a New York bank, Section 10(b) applies. In essence, Plaintiffs seek to revive the "conduct" and "effects" tests previously used in the Second Circuit -- tests that *Morrison* repudiated. Tellingly, Plaintiffs cite no authority for their argument.

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[9] The TAC did not include investors in Ascot Fund, an offshore feeder fund into Ascot, within the definition of the purported class. Plaintiffs subsequently sought to amend the definition of the proposed class to include investors in Ascot Fund. Defendants consented to the requested amendment without waiver of any of their rights with respect to such claims. None of the named plaintiffs invested in the Ascot Fund, however, and Ascot Fund claims should therefore be dismissed for the additional reason that Plaintiffs lack standing to sue. *See, e.g., In re Lehman Bros. Secs. and ERISA Litig.*, 684 F. Supp. 2d 485, 490-91 (S.D.N.Y. 2010) (dismissing claims regarding a fund in which named plaintiffs had not invested).

In fact, *Morrison* applies with equal force to foreign and domestic plaintiffs. *Morrison* explicitly rejected the Second Circuit's "conduct" test precisely because it had resulted in Section 10(b) applying "differently depending on whether the harmed investors were Americans or foreigners." *Morrison*, 130 S. Ct. at 2879. The nationality of plaintiffs thus has no bearing on the applicability of Section 10(b). Accordingly, the lower courts interpreting *Morrison* have uniformly confirmed that *Morrison* bars claims by United States plaintiffs. *See e.g., Plumbers' Union Local No. 12 Pension Fund v. Swiss Reinsurance Co.*, --- F.R.D. ----, No. 08 Civ. 1958, 2010 WL 3860397 (S.D.N.Y. Oct. 4, 2010) (dismissing Section 10(b) claim of United States citizen because the transaction did not occur within the United States); *In re Société Générale Secs. Litig.*, No. 08 Civ. 2495, 2010 WL 3910286, at *5 (S.D.N.Y. Sept. 29, 2010) (same) (citing cases); *Cornwell v. Credit Suisse Grp.*, --- F. Supp. 2d ---, No. 08 Civ. 3758, 2010 WL 3069597, at *5 (S.D.N.Y. July 27, 2010); *see also Stackhouse v. Toyota Motor Co.*, No. CV 10-0922, 2010 WL 3377409, at *1-2 (C.D. Cal. Jul. 16, 2010) (denying lead plaintiff status to U.S. investors who purchased Toyota shares on a Japanese exchange because *Morrison* barred their claims).

Moreover, whether investors in Ariel and Ascot Fund wired money to a U.S. bank to initiate their purchase is irrelevant. "[I]t is a rare case of prohibited extraterritorial application that lacks all contact with the territory of the United States." *Morrison*, 130 S. Ct. at 2884 (rejecting the argument that some activity within the United States turns an investment into a domestic transaction); *see also Plumbers' Union*, 2010 WL 3860397 (dismissing Section 10(b) claim and holding that shares were not purchased within the United States despite the fact that purchase orders were placed electronically by traders located within the United States); *Cornwell*, 2010 WL 3069597, at *5 (after *Morrison*, section 10(b) does not apply to foreign securities "even if some aspects of the transaction occurred in the United States"). Purchases of

shares in Ariel and Ascot Fund constitute neither "transactions in securities listed on domestic exchanges" nor "domestic transactions in other securities." (Open. Br. at 21.) Hence, Plaintiffs' Section 10(b) claims must be dismissed as to Ariel and Ascot Fund investors.

POINT II

THE THIRD AMENDED COMPLAINT FAILS TO STATE A CLAIM FOR CONTROL PERSON LIABILITY

As shown in the Opening Brief and above, Plaintiffs have failed to plead a primary violation of Section 10(b) or "culpable participation" in any such violation. (Open. Br. at 22-23; Point I, *supra*.) Plaintiffs thus fail to state a claim for control person liability.

POINT III

PLAINTIFFS' STATE LAW CLAIMS SHOULD BE DISMISSED

Upon finding that Plaintiffs have not pled a viable Exchange Act claim, the Court should dismiss Plaintiffs' state law claims for lack of subject matter jurisdiction. (Open. Br. at 23-24.) Dismissal of state law claims is especially appropriate here, since the New York Attorney General's civil suit has progressed through discovery, with motions for summary judgment pending, and is therefore much closer to resolution than the instant action. To the extent the Court nevertheless exercises supplemental jurisdiction over the state law claims, each of those claims fails as a matter of law.

A. The State Law Claims Are Preempted By SLUSA

As set forth in Defendants' Opening Brief, Plaintiffs' state law claims meet the four requirements for SLUSA preemption and should therefore be dismissed. (Open. Br. at 24.) Plaintiffs challenge only whether the present action meets the "in connection with the purchase or sale of a covered security" requirement. Specifically, Plaintiffs argue that that requirement is not satisfied because they invested in a hedge fund, which is not a covered security.

The Opening Brief explained that the instant action is "in connection with the purchase or sale of a covered security" because Madoff purported to invest in securities traded on national exchanges. 15 U.S.C. §§ 78bb(f)(1)(A), 77p(b) (West 2010). The Supreme Court has instructed that the "in connection with" requirement should be interpreted broadly, and is satisfied so long as the alleged fraud "coincide with" the sale or purchase of an exchange-traded security. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 85 (2006).

As a result, nearly all courts to consider SLUSA preemption in the context of common law claims against managers of hedge funds that invested with Madoff have found the "in connection with the purchase or sale of a covered security" requirement met through Madoff's purported investments and have therefore dismissed the claims as preempted by SLUSA. *See e.g., Wolff Living Trust v. FM Multi-Strategy Inv. Fund*, LP, No. 09 Civ. 1540, 2010 WL 4457322, at *3 (S.D.N.Y. Nov. 2, 2010); *Newman*, 2010 WL 4118083, at *13; *In re Beacon*, 2010 WL 3895582, at *34; *see also* Open. Br. at 24 (citing cases). Indeed, the only court to hold otherwise is *Anwar II*, the sole authority on which Plaintiffs rely. Contrary to the Supreme Court's directive, *Anwar II* construed the "in connection with" requirement narrowly and allowed plaintiffs' state common law claims to proceed. This Court should follow the vast majority of Courts in this District in applying the Supreme Court's instruction in *Dabit* to dismiss Plaintiffs' state law claims as preempted by SLUSA.[10]

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[10] The Opening Brief also explained that the non-fraud common law claims were preempted by the Martin Act. (Open. Br. at 25.) Since that time, the Appellate Division, First Department, has reversed course and held that the Martin Act does not preempt common law claims involving the purchase or sale of securities. *See Assured Guar. (UK), Ltd. v. J.P. Morgan Inv. Mgmt., Inc.*, 28 Misc. 3d 1215(A), --- N.Y.S.2d ----, No. 3053, 603755/08, M2455, 2010 WL 4721590 (1st Dep't Nov. 23, 2010); *CMMF, LLC v. J.P. Morgan Inv. Management Inc.*, --- N.Y.S.2d ----, No. 3054, 601924/09, M-2430, 2010 WL 4721383 (1st Dep't Nov. 23, 2010). The time for Respondents in those actions to seek review by the Court of Appeals has not yet expired. The authority from the Second Circuit and this District on which Defendants rely remains valid and persuasive, and the non-fraud common law claims asserted by Plaintiffs here should be dismissed for that additional reason.

B. Madoff's Fraud Constitutes A Superseding Criminal Cause That Bars Plaintiffs' State Law Claims For Lack Of Causation

The immediate effective cause of Plaintiffs' alleged injury was Madoff's criminal acts, and Plaintiffs' state law claims thus fail for lack of proximate causation. (Open. Br. at 27-28.) Plaintiffs concede that the intervening criminal act of a third party breaks the chain of causation unless such act is foreseeable. As countless authorities have recognized, Madoff shocked the investing community, including its regulators, when he confessed to running the largest Ponzi scheme in history. (*Id.*) Madoff's fraud was anything but foreseeable. Plaintiffs' common law claims should therefore be dismissed.

C. Plaintiffs Fail To State A Claim For Common Law Fraud

Plaintiffs do not dispute that under New York law, the elements of a fraud claim parallel those of a Section 10(b) claim. Therefore, dismissal of the Section 10(b) claim (*see* Open. Br. at 10-22; *supra* Point I) mandates dismissal of Plaintiffs' claim for common law fraud.

D. The Exculpatory Provisions Of The Limited Partnership And Investment Advisory Agreements Bar The Breach Of Fiduciary Duty, Unjust Enrichment, And Negligent Misrepresentation Claims

Plaintiffs' breach of fiduciary duty, unjust enrichment, and negligent misrepresentation claims are barred by the exculpatory provisions in the LPAs and IAA. (Open. Br. at 29-30.) Plaintiffs do not dispute that the exculpatory clauses are valid and enforceable. Rather, Plaintiffs contend that the exculpatory provisions do not apply here because Plaintiffs allege willful misconduct that falls outside their scope. (Opp. Br. at 49.)

But Plaintiffs' claims of breach of fiduciary duty, unjust enrichment, and negligent misrepresentation do not allege conscious misbehavior beyond the exculpatory provisions. For alleged misconduct to fall within a bad faith exception to an exculpatory provision, courts "set the bar quite high . . . 'demanding nothing short of . . . a compelling demonstration of egregious

intentional misbehavior evincing extreme culpability: malice, recklessness, deliberate or callous indifference to the rights of others, or an extensive pattern of wanton acts.'" *Deutche Lufthansa AG v. Boeing Co.*, No. 06 CV 7667, 2007 WL 403301, at *3 (S.D.N.Y. Feb. 2, 2007). "Even on a motion to dismiss, a court need not accept as true conclusory allegations that a defendant was grossly negligent or acted willfully, in bad faith or with reckless disregard of its duties." *SNS Bank N.V. v. Citibank, N.A.*, 7 A.D.3d 352, 355, 777 N.Y.S.2d 62, 65 (1st Dep't 2004) (affirming dismissal of claims as barred by exculpatory provisions).

Finally, contrary to Plaintiffs' contention, New York and Delaware Courts regularly dismiss claims at the pleading stage based on a valid exculpatory clause. *See e.g., id.*; *Official Comm. of Unsecured Creditors v. Donaldson, Lufkin & Jenrette Secs., Corp.*, No. 00 Civ. 8688, 2002 WL 362794 at *16 (S.D.N.Y. March 6, 2002) (cited in Opp. Br. at 49 n.43) (dismissing negligence and negligent misrepresentation claims as barred by exculpatory provisions). Delaware law is well-summarized by the text Plaintiffs omit when they quote *In re Midway Games*: "where a complaint does not adequately contain facts supporting a claim that directors acted in bad faith or conscious disregard of their responsibilities, dismissal is appropriate" under exculpatory provisions. *In re Midway Games, Inc.*, 428 B.R. 303, 317 (Bankr. D. Del. 2010) (citation omitted).

E. The TAC Does Not State A Claim For Breach Of Fiduciary Duty

As demonstrated in the Opening Brief, Plaintiffs' breach of fiduciary duty claim fails because the Offering Memoranda expressly permitted delegation of investment authority to independent money managers. (Open Br. at 30 (citing cases).) In delegating the Funds' assets to Madoff, Merkin acted in conformity with the express provisions of the Offering Memoranda.

Plaintiffs cannot state a claim for breach of fiduciary duty where, as here, a general partner has in good faith complied with the provisions of a partnership agreement. (*See* Open. Br. at 30.)[11]

F. The TAC Fails To State A Claim For Gross Negligence

Plaintiffs concede that to sustain a claim for gross negligence, they must plead a violation of a legal duty independent of the contract. (Opp. Br. at 46.) Not having done so, Plaintiffs assert, without elaboration, that Defendants had "independent duties that flowed from the governing documents." (Opp. Br. at 46.) Indeed, the TAC offers only a general reference to the Defendants' "duty to exercise due care" in the management of the assets invested in the Funds according to the provisions set forth in the Governing Documents. (Compl. ¶ 265-66.) Such general statements do not sufficiently allege a legal duty independent of the Governing Documents. *See JDA Capital Partners LP v. BNP Paribas Prime Brokerage, Inc.*, No. 106158/09, 2009 WL 2980506, at *17 (N.Y. Sup. Ct. Sept. 8, 2009) (dismissing gross negligence claim, finding no independent legal duty where allegations were failure to act with "reasonable care and diligence"); *Clark-Fitzpatrick Inc. v. Long Island R. Co.*, 70 N.Y.2d 382, 390, 521 N.Y.S.2d 653, 657 (1987) ("Merely charging a breach of 'duty of due care,' employing language familiar to tort law, does not, without more, transform a simple breach of contract into a tort claim."). Plaintiffs' reiteration of conclusory allegations does not save their gross negligence claim.[12]

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[11] Moreover, Plaintiffs have not pled a fiduciary relationship between investors in Ariel and Ascot Fund, which are Cayman Islands corporations, not limited partnerships. Plaintiffs thus do not state a claim for breach of fiduciary duty with respect to Ariel or Ascot Fund. (*See* Open. Br. at 31, n.15.)

[12] Furthermore, "the law is clear that, where the injury alleged is economic in nature ... an action sounding in negligence cannot lie." *TD Waterhouse Investor Servs., Inc. v. Integrated Fund Servs., Inc.*, No. 01 Civ. 8986, 2003 WL 42013 at * 13 (S.D.N.Y. Jan. 6, 2003) (dismissing gross negligence claim where damages were purely economic). Where, as here, "the alleged injury was that Plaintiffs lost the value of an investment ... and where the harm was strictly economic in nature, the facts militate against Plaintiffs' having viable claims in tort as well as in contract." *Oppman v. IRMC Holdings, Inc.*, 14 Misc. 3d 1219(A), 836 N.Y.S.2d 494, No. 600929/2006, 2007 WL 151355, at *12 (N.Y. Sup. Jan. 23, 2007); *see also Deutsche Bank Secs. Inc. v. Rhodes*, 578 F. Supp. 2d 652, 670 (S.D.N.Y. 2008).

G. Plaintiffs Fail To State A Claim For Unjust Enrichment

Plaintiffs' unjust enrichment claim to recover the fees paid by the Funds to Defendants is foreclosed by the existence of valid contractual agreements that cover the subject matter of the claim. (Open. Br. at 33.) It is well-settled that "[a] claim for unjust enrichment, or quasi contract, may not be maintained where a contract exists between the parties covering the same subject matter." *Goldstein v. CIBC World Mkts. Corp.*, 6 A.D.3d 295, 296, 776 N.Y.S.2d 12, 14 (1st Dep't 2004); *see also CSI Inv. Partners II, L.P. v. Cendant Corp.*, 507 F. Supp. 2d 384, 435 (S.D.N.Y. 2007), *aff'd*, 328 F. App'x 56 (2d Cir. 2009); *IDT Corp. v. Morgan Stanley Dean Witter & Co.*, 12 N.Y.3d 132, 142, 879 N.Y.S.2d 355, 361 (2009). Plaintiffs nonetheless argue that because Defendants received fees based on earnings now known to be fraudulent, such fees were "beyond the scope and subject matter of the contracts." (Opp. Br. at 47.) Based on this flawed reasoning, Plaintiffs ask the Court to save their claim for unjust enrichment.

It is undisputed, however, that Defendants' fees were calculated and paid according to the contractual provisions in the Governing Documents. Any claim concerning the Defendants' performance and whether the fees were "earned" is governed exclusively by the agreements between the parties. Plaintiffs' unjust enrichment claim falls squarely within the scope and subject matter of the Governing Documents and should therefore be dismissed. *See, e.g.*, *Michael S. Rulle Family Dynasty Trust v. AGL Life Assur. Co.*, No. Civ. A. 10-231, 2010 WL 3522135, at * 2 (E.D. Pa. Sept. 8, 2010) (dismissing unjust enrichment claims for fees collected based upon "incorrect value" of account due to Madoff fraud).

H. Plaintiffs Fail To State A Claim For Negligent Misrepresentation

The Opening Brief explained that the negligent misrepresentation claim fails because the TAC does not allege reasonable reliance or loss causation. Plaintiffs acknowledge that a claim for negligent misrepresentation requires reasonable reliance, yet simply ignore reasonable

reliance and loss causation. Because Plaintiffs do not and cannot adequately plead reasonable reliance (*see Supra* Point I(C)) or loss causation (*see supra* Point I (D)), the negligent misrepresentation claim must be dismissed on these additional grounds.

I. Croscill And Fuchs Fail To State A Claim For Breach Of Contract

As set forth in the Opening Brief, the Gabriel Offering Memorandum does not constitute a contract. It therefore can not form the basis for Plaintiff Croscill's and Plaintiff Fuchs' breach of contract claims, and those claims should be dismissed. Plaintiffs Croscill and Fuchs do not dispute this point but simply seek leave to attempt to fix their deficient pleadings.

Conclusion

For the foregoing reasons and those set forth in the Opening Brief, Plaintiffs' Third Consolidated Amended Class Action Complaint, as well as the Complaints of Plaintiffs Croscill and Fuchs, should be dismissed in their entirety, with prejudice.

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