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May 29, 2015

VIA FAX

Hon. Victor Marrero
District Judge, United States District Court
Southern District of New York
500 Pearl Street
New York, New York 10007

Re: ***Anwar, et al. v. Fairfield Greenwich Limited, et al.***
Master File No. 09-CV-00118 (VM) (THK)

Dear Judge Marrero:

I write on behalf of my client, PricewaterhouseCoopers LLP ("PwC Canada"), and defendant PricewaterhouseCoopers Accountants N.V. ("PwC Netherlands") (collectively, the "PwC Defendants") pursuant to the Court's May 6, 2015 Order regarding submissions regarding the effect of the Second Circuit's recent decision *In re Kingate Management Limited Litigation*, 784 F.3d 128 (2d Cir. April 23, 2015).[1]

As explained below, the Second Circuit's *Kingate* decision mandates the dismissal of plaintiffs' remaining claims against the PwC Defendants: Count 13 ("Negligence") and Count 14 ("Negligent Misrepresentation"). (Second Consolidated Amended Complaint ("SCAC"), Doc. No. 273 at ¶¶ 433-445 (Sept. 29, 2009).) Both claims require that plaintiffs prove that the PwC Defendants made "a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security," and are therefore precluded by the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"). 15 U.S.C. § 78bb(f)(1)(A).

The *Kingate* Framework

In *Kingate*, the Second Circuit outlined a framework of five categories of claims arising from transactions "in connection with the purchase or sale of a covered security." Claims that a defendant committed fraud ("Group 1"), made a negligent misrepresentation or omission

[1] As ordered by the Court, counsel for the PwC Defendants have conferred with counsel for the other parties to coordinate their submissions. This letter incorporates by reference and adopts the facts and arguments set forth in the letter of this same date submitted by Citco Fund Services (Europe) B.V., Citco (Canada) Inc., Citco Bank Nederland N.V. Dublin Branch, Citco Global Custody N.V., Citco Fund Services (Bermuda) Limited, and The Citco Group Limited (collectively, the "Citco Defendants").

("Group 2"), or aided and abetted a fraud ("Group 3"), are precluded by SLUSA. *Kingate*, 784 F.3d at 151. Claims that allege breach of a contractual, fiduciary, or tort-based duty ("Group 4") or for collateral matters ("Group 5") are not precluded. *Id.* at 135. If the allegations involve conduct that might "otherwise fit" into Group 4 but "require proof" that a defendant "committed knowing, intentional, or negligent misrepresentations or misleading omissions," the claims belong in Groups 1 or 2 and are precluded by SLUSA. *Id.* at 135 n.6.

Application of the *Kingate* Framework to Count 13: Negligence

Count 13 of plaintiffs' complaint alleges that the PwC Defendants were negligent in issuing false audit reports, on which plaintiffs were entitled to rely, and did rely to their detriment. Because this claim depends on proof of a misrepresentation or misleading omission by the PwC Defendants, it falls squarely within Group 2, and is therefore precluded by SLUSA. If all plaintiffs had to prove was negligence on the part of the PwC Defendants, their claim would be a Group 4 claim and would not be precluded by SLUSA. But is clear from well-established New York law, this Court's prior rulings, and their own allegations and admissions, they must prove that the PwC Defendants issued false audit reports. This puts their claims into Group 2.

The *Kingate* court gave as an example of a Group 4 claim a claim by a client of an audit firm that sues the auditor for violation of obligations to the client. 784 F.2d at 148. But unlike the hypothetical plaintiff in the example given by the *Kingate* court, Plaintiffs here were not the PwC Defendants' clients. The PwC Defendants' clients were the Fairfield funds. Plaintiffs here are third parties to the auditor-client relationship between the PwC Defendants and the Fairfield funds. Because plaintiffs do not have privity with the PwC Defendants, their negligence claim must satisfy all the elements required by *Credit Alliance Corp. v. Arthur Andersen & Co.*, 65 N.Y.2d 536, 553 (N.Y. 1985), including reliance on alleged false statements by the PwC Defendants. The plaintiffs have not attempted to, and could not, establish liability based solely on the PwC Defendants' alleged negligence or violation of any contractual or professional obligation. Plaintiffs must prove they relied on false representations by the PwC Defendants in order to prevail on their negligence claims, which places their claims in Group 2.[2]

[2] New York courts have recognized that third-party negligence claims based on alleged false statements by an auditor are equivalent to negligent misrepresentation claims. *See Cromer Finance Ltd. v. Berger*, 137 F. Supp. 2d 452, 495 n. 29 (S.D.N.Y. 2001) (analyzing a third-party negligence claim against an auditor as a claim for negligent misrepresentation where the allegation was that negligent auditing led to a misrepresentation of a fund's financial condition). *See also* Thomas G. Mackey, Note, *Accountants' Liability after Bily v. Arthur Young*, 45 Hastings L.J.

The record in this case allows no other conclusion. First, the alleged factual basis of plaintiffs' claim is that the PwC Defendants issued false audit opinions. Plaintiffs allege:

- The PwC Defendants issued "clean" audit opinions. (SCAC ¶¶ 261-67.)
- The PwC Defendants knew plaintiffs "would rely" on the fact that they "represented [they] conducted proper audits of the Funds, and issued unqualified, or clean, opinions on the Funds' financial statements." (SCAC ¶ 277.)
- The PwC Defendants misrepresented that they had "reasonable assurance" that the funds' financial statements "were free of material misstatement." (SCAC ¶ 304.)
- The PwC Defendants "opin[ions] that the multi-billion dollar valuations of the Funds' investments were fairly presented in the financial statements" were unfounded. (SCAC ¶ 305.)
- "As the independent party charged with certifying that it had reasonable assurance that the Funds' financial statements were free of material misstatement, PwC failed to meet its obligation to the Funds' investors when it issued its audit opinions – opinions upon which it knew those parties would rely." (SCAC ¶ 312.)
- The PwC Defendants' "audit reports ***misrepresented*** that [they] had conducted the audits in compliance with GAAS and ISA and ***misrepresented*** that the Funds' financial statements set out the true financial condition of the Funds." (SCAC ¶ 316 (emphasis added).)

Second, this Court has previously recognized that plaintiffs must show that the PwC Defendants owed them a duty of care under *Credit Alliance* by: (1) pointing to a "statement" by the PwC Defendants that the auditors knew would be used for a particular purpose, (2) "reliance by a known party on that statement," and (3) conduct by the auditors "linking it to the relying party and evincing its understanding of that reliance." *Anwar v. Fairfield Greenwich Ltd.*, 884 F. Supp. 2d 92, 95 (S.D.N.Y. 2012) ("*Anwar II*"). This Court has also recognized that plaintiffs'

147, 161 (1993) ("The very function of accountants that exposes them to liability is not so much the negligent performance of the audit, as it is the representations made regarding the results of the audit.").

claims are "shareholders' tort claims ***based on misrepresentation***, rather than mismanagement." *Id.* at 99 (emphasis added). If plaintiffs cannot prove the PwC Defendants made a false statement, on which they relied, they cannot establish that the PwC Defendants owed them a duty of care, let alone establish liability.

Third, plaintiffs themselves have repeatedly argued that they are ***entitled*** to sue the PwC Defendants for negligence under the *Credit Alliance* standard ***precisely because*** they were entitled to rely, and did rely, on the allegedly false statements in the PwC Defendants' audit reports. As they argued to the Second Circuit on the Rule 23(f) appeal – under the heading "Common Evidence Establishes Reliance on PwC Audit Opinions":

> The claims now remaining in this case against PwC are limited to injuries suffered by those Fund shareholders who made additional investments (or held existing investments) after PwC ***issued an audit opinion addressed to those shareholders***. All such audit opinions, of course, gave the Funds a clean bill of health. It defies reason and common sense to claim that Class members did not rely on the audits in making or holding investments, since anything other than a "clean" audit is anathema to investors.
>
> Both direct and circumstantial evidence show reliance on PwC's ***misrepresentations*** on a class-wide basis. ***PwC's "clean" audit reports misrepresented*** that the Funds held valuable assets and engaged in extensive trading that produced large profits; ***the reports further misrepresented*** that PwC had verified these facts through proper auditing processes.

St. Stephens School v. PricewaterhouseCoopers Accountants N.V., Dkt. No. 13-2340, Brief for Plaintiffs-Appellees at 60 (Oct. 11, 2013) (emphasis added; internal citations omitted).

The negligence claim ***cannot*** be characterized as a Group 4 claim under *Kingate*, because Group 4 claims are those that "would not require any showing of false conduct on the part of the defendants." Plaintiffs' negligence claim is expressly based on the allegation that the PwC Defendants issued audit reports that misrepresented the financial condition of the funds and the PwC Defendants' audit work. Accordingly, Plaintiffs' negligence claim is a Group 2 claim, requiring proof of "negligent misrepresentations and misleading omissions in connection with

the Funds' investments with Madoff," *Kingate*, 784 F.3d at 151, and is therefore precluded by SLUSA.[3]

Application of the *Kingate* Framework to Count 14: Negligent Misrepresentation

Plaintiffs' negligent misrepresentation claim also falls into Group 2. (SCAC ¶¶ 438-445.) In addition to sharing the same alleged basis in fact and the same requirement to establish a duty of care on the part of the PwC Defendants under *Credit Alliance*, plaintiffs' particular allegations in Count 14 are that the PwC Defendants "induced purchasers to hold their positions in the Funds and to purchase additional interests in the Funds ***by falsely representing*** to Plaintiffs that (i) [they] had conducted [their] audits in accordance with GAAS or ISA and (ii) the Funds' financial statements 'present[ed] fairly, in all material respects, the financial positions of [the Funds]," (SCAC ¶ 440 (emphasis added)), and that as "a result of their reliance upon the false representations made by PwC, Plaintiffs have suffered damages." (*Id.* at ¶ 445.) It is hard to imagine a claim more closely tailored for preclusion under SLUSA for alleging a misrepresentation in connection with the purchase or sale of a covered security.

Conclusion

Because both of Plaintiffs' remaining claims for negligence and negligent misrepresentation against the PwC Defendants require proof of "false conduct" they are precluded by SLUSA under *Kingate*, and should be dismissed.

The Clerk of Court is directed to enter into the public record of this action the letter above submitted to the Court by PwC Defendants.

SO ORDERED.

5-29-15
DATE

VICTOR MARRERO, U.S.D.J.

cc: Counsel of Record (via e/mail)

Respectfully,

Timothy A. Duffy, P.C.

[3] The Second Circuit has made it clear that the scope of "false conduct" claims precluded under SLUSA is broad, and encompasses "all the types of misleading or deceptive conduct identified in the relevant SLUSA provisions (including a misrepresentation of a material fact, an untrue statement, and the use or employment of any manipulative or deceptive device or contrivance)." *Kingate*, 784 F.3d at 132 n.1. This is consistent with the scope of potential liability under the securities laws, where the issuance of a false audit opinion by the PwC Defendants would likewise come within the scope of a potential enforcement action by the SEC, notwithstanding the lack of a private right of action under those laws against the PwC Defendants. *Id.* at 151 & nn. 21 & 22.