

**UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK**

ANWAR, *et al.*

Plaintiffs,

v.

FAIRFIELD GREENWICH LTD., *et al.*,

Defendants.

MASTER FILE NO.

09-CV-00118 (VM)

**PwC DEFENDANTS' MEMORANDUM OF LAW
IN OPPOSITION TO PLAINTIFFS' MOTION *IN LIMINE* NO. 1 TO
EXCLUDE EVIDENCE CONCERNING AUDITS OF NON-FAIRFIELD FUNDS**

FILED UNDER SEAL PURSUANT TO CONFIDENTIALITY ORDER

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TABLE OF CONTENTS

	Page
PRELIMINARY STATEMENT	1
ARGUMENT	3
I. Evidence That Other Similarly Situated Auditors Did Not Perform The Procedures Plaintiffs Claim Were Required Is Critical To A Fair Cross- Examination Of Plaintiffs' Expert.	3
II. The Evidence Is Directly Relevant To The Standard Of Care.....	7
III. There Is A Sufficient Evidentiary Basis And The Probative Value Of The Evidence Is Not Substantially Outweighed By A Danger Of Unfair Prejudice Or Jury Confusion.	9
CONCLUSION.....	11

TABLE OF AUTHORITIES

	Page(s)
CASES	
<i>Estate of Burke v. Repetti & Co.</i> , 255 A.D.2d 483 (2d Dep’t 1998)	7
<i>Galvin v. N.Y. Racing Ass’n</i> , 70 F. Supp. 2d 163 (E.D.N.Y. 1998), <i>aff’d</i> , 166 F.3d 1200 (2d Cir. 1998).....	5, 6
<i>George v. Celotex Corp.</i> , 914 F.2d 26 (2d Cir. 1990)	9
<i>Goldberg v. Kelly</i> , 397 U.S. 254 (1970)	5
<i>Hollman v. Taser Int’l Inc.</i> , 928 F. Supp. 2d 657 (E.D.N.Y. 2013)	5
<i>Lee v. Penn. R. Co.</i> , 192 F.2d 226 (2d Cir. 1951).....	7
<i>Mahon v. Reading Co.</i> , 367 F.2d 25 (3d Cir. 1966)	6
<i>MBIA Ins. Corp. v. Patriarch Partners VIII, LLC</i> , No. 09 CIV. 3255, 2012 WL 2568972 (S.D.N.Y. July 3, 2012)	5, 9
<i>Mishkin v. Peat, Marwick, Mitchell & Co.</i> , 744 F. Supp. 531 (S.D.N.Y. 1990)	7, 8
<i>Park W. Radiology v. CareCore Nat’l LLC</i> , 675 F. Supp. 2d 314 (S.D.N.Y. 2009).....	10,11
<i>Phillips v. McClellan St. Assocs.</i> , 262 A.D.2d 748 (3d Dep’t 1999).....	7
<i>Reach Music Pub., Inc. v. Warner Chappell Music, Inc.</i> , 988 F. Supp. 2d 395 (S.D.N.Y. 2013)	5
<i>Walker v. Firestone Tire & Rubber Co.</i> , 412 F.2d 60 (2d Cir. 1969).....	5
STATUTES AND RULES	
Fed. R. Evid. 403	9
N.Y. Pattern Jury Instructions 2:154 (2014).....	7

Defendants PricewaterhouseCoopers Accountants N.V. and PricewaterhouseCoopers LLP (collectively, the “PwC Defendants”) respectfully submit this memorandum of law in opposition to Plaintiffs’ Motion *in Limine* No. 1 seeking to exclude evidence that auditors of non-Fairfield Funds that invested with Bernard L. Madoff Investment Securities (“BLMIS”) did not perform the procedures Plaintiffs and their expert claim were required.

PRELIMINARY STATEMENT

Plaintiffs rest their sole remaining negligence claim on the premise that the PwC Defendants were required to perform certain audit procedures specified by their expert. In asserting that the procedures they advocate were required procedures, Plaintiffs seek to hide from the jury through their motion *in limine* the inconvenient truth that some 25 other audit firms performed well over 100 audits on similarly structured, Madoff-advised funds (including 11 audits performed by another audit firm on one of the Funds at issue here), and none of those audit firms performed the procedures Plaintiffs claim were required, uncovered Madoff’s fraud, or issued anything but unqualified opinions.¹

Plaintiffs’ motion to exclude this critical evidence should be denied for several reasons. First, the evidence is necessary to a proper evaluation of the reliability of the opinions offered by

1. The list of these auditors includes: BDO Seidman LLP (Ariel Fund, Ascot Partners, Ascot Fund, Gabriel Capital); Berkow Schechter (Greenwich Sentry); Ernst & Young LLP (Rye Select Broad Market Fund); Deloitte Bahamas (Skyewest Limited); Deloitte BVI (White Orchard Investments); Deloitte France (Mount Capital); Deloitte Gibraltar (Vizcaya Partners); Deloitte Ireland (Mount Capital, The Mizar Fund); ERE LLP (Optima Limited Partnership, Sienna Partnership); Ernst & Young LLP (American Masters Broad Market Fund); E&Y Bahamas (Harley International); E&Y Cayman (Primeo Select Fund, Primeo Executive Fund, Santa Clara Holdings); E&Y Curacao (Harley International); E&Y Luxembourg (Herald Fund SPC, Thybo Funds); E&Y Netherlands (Thybo Asset Management); Friedberg, Smith & Co. (Beacon Associates LLC); Fulvio & Associates (FM Multi-Strategy Investment Fund); Goldstein Golub Kessler (Maxam Absolute Return Fund, American Masters Broad Market Fund, MUUS Independence Fund); KPMG LLP (Rye Select Broad Market Fund, American Masters Broad Market Fund, Optimal Multiadvisors); KPMG (Cayman) (Tremont Funds); KPMG UK (Tremont Funds); Lazar Levine & Felix (First Frontier, LP); Margolin, Winer & Evans (Income-Plus Investment Fund); Mazars & Guerard (Finanaciere Agache); McGladrey & Pullen (Maxam Absolute Return Fund); PwC Bermuda (Kingate Euro Fund, Kingate Global Fund); PwC Ireland (Thema International Fund); RBA SA (Vizcaya Partners); Rothstein, Kass & Co. (Lanx BM Investments); Schwartz & Company (Excelsior Investment Fund, Excelsior Qualified LP).

the Plaintiffs' audit expert, Dr. Douglas R. Carmichael. Dr. Carmichael has never signed an audit report or participated in the audit of an investment fund, yet he opines that the PwC Defendants were required to perform certain additional procedures, which he says would have revealed Madoff's fraud. Dr. Carmichael's opinion is undermined by the fact that every other similarly situated auditor issued an unqualified opinion without performing the procedures that he says were required. Due process requires that the PwC Defendants be permitted to cross-examine Dr. Carmichael about this evidence, which contradicts and undermines his opinions.

This evidence is also admissible as substantive evidence to establish the applicable standard of care. Under New York law and the applicable auditing standards, the relevant standard of care is that which a reasonably skillful and diligent auditor would use under similar circumstances. Although not determinative, evidence that other auditors in similar circumstances did not perform the procedures Plaintiffs claim were required may be considered by the jury.

Finally, Plaintiffs are wrong in asserting that there is no evidentiary basis and that the probative value of the evidence is substantially outweighed by the danger of unfair prejudice or confusion of the issues. The evidence may defeat Plaintiffs' theories, but that does not make it inadmissible. Further, while Plaintiffs raise the specter of a series of "mini-trials" on whether each audit complied with the professional standards, such threats are unfounded. The introduction of this evidence does not require any excursion into the adequacy of other audits. Rather, the relevant evidence – that the other auditors issued unqualified audit opinions without performing the specific procedures Plaintiffs and their expert say were required – is largely undisputed and can be introduced through a handful of exhibits and straightforward questioning of the parties' experts and other witnesses who are already going to testify.

ARGUMENT

I. Evidence That Other Similarly Situated Auditors Did Not Perform The Procedures Plaintiffs Claim Were Required Is Critical To A Fair Cross-Examination Of Plaintiffs' Expert.

Plaintiffs' expert, Dr. Carmichael, has staked out the extreme position that no reasonable or competent auditor could have issued an unqualified opinion on the financial statements of a fund with substantially all of its assets at BLMIS without performing certain procedures that he claims would have revealed the fraud. Plaintiffs now seek to shield their expert from cross-examination about how he conveniently interpreted the professional standards to require every "reasonable and competent" auditor to perform these specific procedures despite the contrary evidence that every professional auditor that audited a fund with substantial assets at BLMIS issued an unqualified report without performing the procedures he claims were required.

Dr. Carmichael interprets the professional standards to require an auditor of a fund with substantially all its assets at BLMIS to either independently verify with the Bank of New York or Depository Trust Company the existence of the assets held by BLMIS or, alternatively, review the work papers of BLMIS's auditor. (*See* Decl. of Sarah L. Cave in Supp. of the PwC Defs.' Mem. of Law in Opp'n to Pls.' Mots. *in Limine* ("Cave Decl.") Ex. 1 (Carmichael Rep. at 15, 154-56); *see also* Cave Decl. Ex. 2 (Carmichael Rebuttal Rep. at 32, 36); Cave Decl. Ex. 3 (Carmichael Tr. 63:17-64:3).)²

2. Dr. Carmichael opines that had such procedures been performed the auditor would have discovered Madoff's fraud and would not have issued an unqualified opinion. (Cave Decl. Ex. 1 (Carmichael Rep. at 15 (attempts to confirm existence of assets with BONY would have led the PwC Defendants "to resign or issue a disclaimer of opinion"), 17 ("An auditor who adhered to professional standards would not have been able to issue an unqualified, or *clean*, opinion in the circumstances encountered by the PwC defendants . . ."), 156 (noting that performance of one of the two procedures would have revealed Madoff's Ponzi scheme)); Cave Decl. Ex. 2 (Carmichael Rebuttal Rep. at 34, 46 (same), 54 (performance of one of two procedures would have revealed "that there was no evidence the investments existed"), 64 ("had the existing standards been followed . . . either Madoff's deception would have been revealed, or a reasonable, competent auditor would have recognized that an unqualified opinion could not be expressed"), *id.* ("if properly applied [the professional standards] would have resulted in discovery of the fraud or in a disclaimer of opinion")); Cave Decl. Ex. 3 (Carmichael Tr.

Dr. Carmichael opines that in the circumstances no reasonable auditor could have issued an unqualified opinion without performing one of these procedures.³ Indeed, Dr. Carmichael emphasized that, while “it is quite possible” that an auditor might issue an unqualified report without performing the procedures he advocates, in his “judgment then they would not be a – a reasonable or competent auditor. So a reasonable or competent auditor in the circumstances . . . could not have expressed an unqualified opinion.” (Cave Decl. Ex. 3 (Carmichael Tr. 98:20-99:1).)

Dr. Carmichael’s reading of the professional standards is the only basis for his opinion. He has no experience in performing audits of investment funds and, indeed, has never signed an audit report of any kind. (*Id.* at 253:8-19, 258:3-7.) His dismissal of the uniform practice of more than 25 audit firms that performed more than 100 audits of funds similar to those at issue in this case is fair and necessary grounds for impeachment.

Dr. Carmichael similarly dismisses the contrary interpretation of the standards in the governing professional literature – the American Institute of CPAs’ (“AICPA”) Audit Guide – as “clearly wrong.” (*Id.* at 199:8-12; 291:21-292:1.) It would be grossly misleading to permit Dr. Carmichael to present his interpretations of the standards without full cross-examination of all the contrary evidence. That evidence includes the profession’s Audit Guide and the unqualified opinions of other auditors of funds with substantial assets at BLMIS, both of which he casually dismisses, and his extreme position that all of the auditors who issued all of those opinions were not reasonable or competent.

104:13-21 (“someone following the standards would have . . . either detected the fraud or concluded that there was a scope limitation and they were unable to express an unqualified opinion”).)

3. (Cave Decl. Ex. 3 (Carmichael Tr. 97:17-24 (“[N]o reasonable or competent auditor of a fund that [had] placed substantially all of [its] assets with Madoff in the circumstances where there were all the risks that were known to those auditors, as in this case, would have given an unqualified opinion in the circumstances . . .”).))

The PwC Defendants have separately sought exclusion of Dr. Carmichael’s opinions, but where expert testimony is deemed admissible, “vigorous cross examination, presentation of contrary evidence, and careful instruction on the burden of proof are the traditional and appropriate means” to attack the expert evidence. *See, e.g., MBIA Ins. Corp. v. Patriarch Partners VIII, LLC*, No. 09 CIV. 3255, 2012 WL 2568972, at *15 (S.D.N.Y. July 3, 2012); *see Hollman v. Taser Int’l Inc.*, 928 F. Supp. 2d 657, 670 (E.D.N.Y. 2013) (“[I]t is up to the opposing party to examine the factual basis for the opinion in cross-examination.”). Plaintiffs admitted as much in their opposition to the PwC Defendants’ *Daubert* motion, where they argued that challenges to the “reasoning, weaknesses that may be asserted in an expert’s analysis, including whether there is a sufficient factual basis for the expert’s opinion or whether assumptions are unfounded” are matters that go to the weight the jury should place on the opinions at issue. (Pls.’ *Daubert* Opp’n Br. at 3.) This is particularly true where, as is the case with Dr. Carmichael, the expert at issue is one on which “virtually the whole of plaintiff’s case [is] based.” *Walker v. Firestone Tire & Rubber Co.*, 412 F.2d 60, 64 (2d Cir. 1969) (reversing verdict where trial court unduly limited cross-examination of key expert).

Accordingly, the PwC Defendants must be permitted to cross-examine Dr. Carmichael about what similarly situated auditors actually did, which he entirely ignored and which is inconsistent with his opinions. *See Reach Music Pub., Inc. v. Warner Chappell Music, Inc.*, 988 F. Supp. 2d 395, 405 (S.D.N.Y. 2013) (contention that expert’s opinion omitted “important facts . . . may be explored on cross-examination”). Failure to permit cross-examination as to so central an issue would raise serious due process concerns. *Goldberg v. Kelly*, 397 U.S. 254, 269 (1970) (“In almost every setting where important decisions turn on questions of fact, due process requires an opportunity to confront and cross-examine adverse witnesses.”), *quoted in Galvin v.*

N.Y. Racing Ass'n, 70 F. Supp. 2d 163, 178 (E.D.N.Y. 1998), *aff'd*, 166 F.3d 1200 (2d Cir. 1998); *see Mahon v. Reading Co.*, 367 F.2d 25, 27 (3d Cir. 1966) (“[T]he right of cross-examination inheres in every adversary proceeding and . . . if cross-examination of an available witness is not had the litigant, deprived of cross-examination, has been denied due process of law.”) (quotations omitted).

Plaintiffs’ attempt to preclude any inquiry of Dr. Carmichael as to what similarly situated auditors did on the grounds that the other auditors did not audit the Funds at issue here is meritless. (Pls.’ Mot. at 7 (“no auditors faced the exact same circumstances as PwC”).) Like the PwC Defendants, the auditors of other Madoff-invested funds faced situations in which a substantial portion of their clients’ assets were invested with and held by Madoff. That is the circumstance that Dr. Carmichael believes required the procedures that he claims would have revealed the fraud and precluded issuance of an unqualified audit opinion. That is the circumstance that led Dr. Carmichael to stake out his position that no reasonable or competent auditor would have issued an unqualified opinion without performing the procedures he advocates. Indeed, when it suits his purposes, Dr. Carmichael has no hesitation in relying on the conduct of auditors of other Madoff-invested funds, which he says were faced with the “identical” circumstances as the PwC Defendants.⁴

Accordingly, it would be misleading and unfairly prejudicial to permit Dr. Carmichael, an expert who has never signed an audit report, to testify about his opinion about what a reasonable auditor would have done in similar circumstances without permitting him to be cross-

4. (Cave Decl. Ex. 3 (Carmichael Tr. 125:24-126:02 (relying on audit of Kingate funds)); *see* Cave Decl. Ex. 2 (Carmichael Rebuttal Rep. at 21).) Plaintiffs also freely refer to evidence regarding audits of other Madoff-invested funds when it ostensibly supports their theories. *See* SCAC ¶¶ 271, 274 (conflating audits at issue with other audits conducted by other, non-party PwC firms to improperly impute knowledge of non-party auditors to PwC Defendants); *see also* Pls.’ Mot. at 8 (relying on audits conducted by PwC member firms of Optimal, Kingate and Thema funds).

examined about the fact that no real auditor faced with similar circumstances ever performed the procedures he says were required.

II. The Evidence Is Directly Relevant To The Standard Of Care.

In addition to being necessary for a fair cross-examination of Plaintiffs' expert, the evidence that no other similarly situated auditors performed the procedures that Dr. Carmichael claims were required is relevant to establishing the standard of care.

Under New York law, the PwC Defendants had the duty to use the same degree of skill and care in their audits as a reasonably skillful and diligent auditor would use under similar circumstances. *See* N.Y. Pattern Jury Instructions 2:154 (2014); *Estate of Burke v. Repetti & Co.*, 255 A.D.2d 483 (2d Dep't 1998) ("A claim of professional negligence requires proof that there was a departure from the accepted standards of practice . . .").

Proof of a generally accepted practice, custom or usage within a particular trade or industry is admissible concerning the standard of care for negligence claims. *See Lee v. Penn. R. Co.*, 192 F.2d 226, 229 (2d Cir. 1951) (evidence of "practices of others may be adduced in order to place an allegation of negligence in a context of general usage, thus assisting the jury in formulating the standard of care of reasonable men"); *Phillips v. McClellan St. Assocs.*, 262 A.D.2d 748, 749 (3d Dep't 1999) ("Clearly, evidence of industry practice and standards is admissible to establish a duty of care . . ."). Accordingly, the degree of care actually practiced by other auditors in similar circumstances is relevant evidence to establishing the applicable standard of care. *See Mishkin v. Peat, Marwick, Mitchell & Co.*, 744 F. Supp. 531, 538 (S.D.N.Y. 1990) (auditors undertake "to observe generally accepted auditing standards and

professional guidelines, with the appropriate reasonable, honest judgment that a reasonably skillful and prudent auditor would use under the same or similar circumstances”).⁵

The professional standards likewise make clear that the conduct of similarly situated auditors is relevant to evaluating the PwC Defendants’ conduct. Under generally accepted auditing standards, the PwC Defendants were required to plan and perform their audits with “due professional care,” which is defined as “the degree of skill commonly possessed by others in the same employment.” AU § 230.03 (quoting *Cooley on Torts*); see also ISA § 200.4 (auditor should act with “professional competence and due care”). As explained by the PwC Defendants’ audit experts, this means that consideration must be given to how auditing standards are actually applied by auditors in the field in similar circumstances.⁶

Where Plaintiffs claim that the PwC Defendants had a duty to perform certain procedures in order to issue an unqualified opinion, the fact that so many auditors issued unqualified reports without performing those procedures is clearly relevant. Indeed, it would be misleading and prejudicial to permit the jury to be told about the procedures that Dr. Carmichael claims are required without disclosing to the jury that those procedures were never performed by any auditor in similar circumstances. The PwC Defendants’ audit experts both concluded that the

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5. None of the cases cited by Plaintiffs stand for the proposition that evidence of what other auditors did in similar circumstances is irrelevant to determining the appropriate standard of care for a professional negligence claim. See *Davis v. Greiner*, 428 F.3d 81,83 (2d Cir. 2005) (habeas challenge based on ineffective assistance of counsel); *Kingsway Fin. Servs., Inc. v. Pricewaterhouse-Coopers LLP*, No. 03 CIV. 5560 RMB HBP, 2006 WL 1520227, at *3 (S.D.N.Y. June 1, 2006) (resolution of discovery disputes with reference, *in dicta*, to the fact that under Rule 404(b) evidence of auditor’s prior conduct in other audits is inadmissible bad acts evidence), *reconsideration denied*, 2008 WL 4200601 (S.D.N.Y. Sept. 12, 2008); *In re Conticommodity Servs., Inc., Sec. Litig.*, MDL No. 644, 1988 WL 56172, at *2 (N.D. Ill. May 25, 1988) (denying motion to compel production of auditor’s internal manual). In fact, the court in *In re Conticommodity* recognized that the standard of care “requires that an accountant exercise that degree of skill and competence reasonably expected of persons in the accounting field in the community.” *Id.* at *1.
 6. (*E.g.*, Cave Decl. Ex. 4 (Temkin Rep. at 4 (“Auditing standards, whether U.S. GAAS or ISAs, gain their authority not only by being issued by an authoritative standard-setting body, but also by how they are applied by auditors. The judgment required to apply the standards and exercised by auditors in different situations defines and determines the real meaning and impact of the standard, and makes the standard that by which the conduct of an individual auditor can and should be judged.”))).)

procedures identified by Dr. Carmichael were not required by the applicable standard of care.

As contemplated by the professional standards, that conclusion is corroborated by the fact that no other auditor of a Madoff-invested fund performed the procedures before issuing an unqualified audit opinion. (*See, e.g.*, Cave Decl. Ex. 4 (Temkin Rep. at 25); Cave Decl. Ex. 5 (Meyerowich Rep. at 118-22, Ex. 9).) The jury is entitled to consider this evidence in evaluating the basis for the opinions of the PwC Defendants' experts and weighing that against Dr. Carmichael's beliefs.

III. There Is A Sufficient Evidentiary Basis And The Probative Value Of The Evidence Is Not Substantially Outweighed By A Danger Of Unfair Prejudice Or Jury Confusion.

In seeking to exclude this evidence, Plaintiffs also invoke Rule 403 and claim that admission of what other auditors actually did would be unfairly prejudicial and lead to unnecessary mini-trials and confusion of the issues. Plaintiffs' worries are misguided.

First, under Rule 403, Plaintiffs have to establish that the probative value is "substantially outweighed" by the danger of unfair prejudice or confusion of the issues. Fed. R. Evid. 403. Here, the probative value of the evidence cannot be overstated. The evidence is directly relevant to one of the central issues in this case – the standard of care applicable to the sole remaining claim of negligence. The level of unfair prejudice and confusion that Plaintiffs would have to show to justify exclusion in these circumstances is extremely high. *See George v. Celotex Corp.*, 914 F.2d 26, 31 (2d Cir. 1990) ("Because Rule 403 permits the exclusion of probative evidence, it is an extraordinary remedy that must be used sparingly."). Plaintiffs have not made any such showing. The fact that evidence undermines Plaintiffs' case does not make the admission of the evidence *unfairly* prejudicial. *See, e.g., id.* at 31 ("Any prejudice to [defendant] was derived from the [evidence]'s probative force and thus it did not *unfairly* prejudice [defendant]."); *MBIA Ins. Corp.*, 2012 WL 2568972, at *11 ("Evidence cannot be excluded under [Rule] 403 on the

basis that, due to its relevance, such evidence has a negative impact on a party's litigation position.”).

Nor will the evidence confuse the issues, much less raise a risk of confusion that substantially outweighs the probative value of the evidence. Contrary to Plaintiffs' assertion, there is no need to have “mini trials” regarding the other auditors' conduct. (Pls.' Mot. at 1.) The PwC Defendants are not seeking to have a trial on whether each other auditor conducted its audits in accordance with the professional standards; that simply does not matter. The only purpose is to establish that every other similarly situated auditor issued an unqualified opinion without performing the specific procedures that Plaintiffs and Dr. Carmichael claim were required. The evidence necessary to establish this point is straightforward and largely undisputed. The PwC Defendants will principally rely on Dr. Carmichael's admissions that he is not aware of any other auditor who performed such procedures, and that he is of the opinion that if anyone had done so they would have discovered the fraud. (Cave Decl. Ex. 3 (Carmichael Tr. 99:7-17, 100:24-101:5, 104:13-21); Cave Decl. Ex. 2 (Carmichael Rebuttal Rep. at 64).) The PwC Defendants will also rely on the unqualified audit reports on the financial statements of other Madoff-invested funds, and the BLMIS confirmations that the auditors who issued those unqualified audit reports requested.⁷ That evidence alone is sufficient to establish that the other auditors issued unqualified reports while relying on BLMIS confirmations and without performing the specific procedures that Plaintiffs claim were required. There is no need to conduct any separate “trial” regarding each audit beyond those simple and indisputable facts, which bear directly on the central issue in this case. *Cf. Park W. Radiology v. CareCore Nat'l*

7. The PwC Defendants will also offer the testimony of Scott Watson-Brown, who led the audits of the Kingate funds, Susan Geigel, who testified on behalf of the Depository Trust Company, and Ed Schechter, whose company audited the Greenwich Sentry fund prior to the PwC Netherlands, as well as certain documents from the audit files of Mr. Schechter's company. All of this evidence is independently admissible, in any event.

LLC, 675 F. Supp. 2d 314, 325 (S.D.N.Y. 2009) (excluding evidence of fraud by nonparties that had “tangential bearing, if at all” and risked “turning the trial into a ‘multi-ringed sideshow of mini-trials on collateral issues pertaining to the conduct and relationships of third parties’”) (citation omitted).


Far from it being unfairly prejudicial and confusing to admit this evidence, it would be grossly misleading and unfairly prejudicial to the PwC Defendants to permit the Plaintiffs and their expert to argue to the jury that a reasonable auditor in similar circumstances would have performed certain procedures without permitting the jury to consider the fact that no actual auditor faced with similar circumstances actually performed those procedures.

CONCLUSION

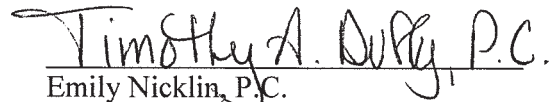
For the foregoing reasons, Plaintiffs’ Motion *in Limine* No. 1 should be denied.

Dated: New York, New York
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Respectfully submitted,



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