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. 2 TO PRECLUDE REFERENCE TO NON-AUDIT INQUIRIES, EXAMINATIONS AND INVESTIGATIONS OF MADOFF AND BLMIS

FILED UNDER SEAL PURSUANT TO CONFIDENTIALITY ORDER

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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. 2 seeking to preclude evidence of "Non-Audit Inquiries, Examinations and Investigations of Madoff and BLMIS" other than those conducted by the U.S. Securities and Exchange Commission ("SEC").

PRELIMINARY STATEMENT

By moving to exclude evidence of the fact that Madoff and BLMIS were subject to extensive regulatory oversight, not just by the SEC, but also by the Financial Industry Regulatory Authority ("FINRA"), the Internal Revenue Service ("IRS"), and the New York State Department of Taxation, Plaintiffs seek to hide from the jury the complete picture of the regulatory framework under which BLMIS operated. When planning and conducting their audits, the PwC Defendants knew that BLMIS was a highly regulated broker-dealer. The entire framework of regulatory oversight and examination to which BLMIS was subject was part of the context in which the PwC Defendants' audits were performed. The evidence of the full framework is therefore relevant and should be admitted, just as Plaintiffs concede is the case with respect to the SEC's examinations and investigations.

Evidence of the fact that Madoff and BLMIS were investigated by regulators besides the SEC and were the subject of specific due diligence reviews by KPMG is also relevant to the issue of proximate cause. Plaintiffs incorrectly suggest that the PwC Defendants seek to argue that the investigations were the same as financial statement audits. Rather, the fact that government regulators with direct supervisory responsibility and full subpoena power, like those conducting specific due diligence investigations seeking to assess the risk of fraud at BLMIS, were unable to discover that the assets invested with Madoff did not exist is relevant to

determining whether the PwC Defendants' audits complied with the professional standards, and if they did not, whether that failure proximately caused Plaintiffs' losses.

Finally, Plaintiffs are wrong that the evidence should be excluded due to confusion of the issues under Rule 403 because "mini-trials" about each investigation will be required. To the contrary, the regulatory framework and the investigations into Madoff and BLMIS can be introduced through a handful of documents and discussed by the parties' experts. Indeed, there is no principled basis for admitting evidence about the SEC and its investigations while excluding any evidence of similar examinations by other regulators and entities. The jury should be provided with the full picture.

ARGUMENT

I. The Entire Regulatory Framework Under Which BLMIS Operated Is Relevant As Part Of The Context In Which The Audits Were Conducted.

Plaintiffs claim that evidence of the numerous examinations and investigations conducted by the regulators, other than the SEC, responsible for overseeing BLMIS is irrelevant because those regulators were not conducting audits under the applicable professional auditing standards. (Pls.' Mot. at 1.) But this argument simply misses the point.

The fact that the regulators were not subject to the professional auditing standards has nothing to do with the relevance of the regulatory oversight under which BLMIS operated. The evidence is relevant because, in conducting their audits, the PwC Defendants understood and considered that BLMIS was a highly regulated broker-dealer that operated within an extensive regulatory framework. This fact led the PwC Defendants, and every other similarly situated auditor, to rely on BLMIS confirmations in the course of their audits, just as they would rely on confirmations from other reputable and regulated broker-dealers. Indeed, Plaintiffs effectively concede the relevance of this evidence by agreeing that evidence of the SEC's regulation and

examinations of BLMIS should be admitted. There is no justification for presenting an incomplete picture of the extensive regulation to which BLMIS was subject by leading the jury to believe that only the SEC was involved.

Rather, the jury must know that BLMIS was regulated and subject to regular examinations by FINRA. *See* 15 U.S.C. 78o-4(c)(7) (requiring FINRA to conduct periodic examinations of broker-dealers). In particular, BLMIS was examined by FINRA's market regulation department on an annual basis and by FINRA's member regulation department on a biennial basis, including in 2003, 2005 and 2007. (*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. 6 (Lundelius Rep. ¶¶ 195-96, 198-200); Cave Decl. Ex. 7 (Report of the 2009 Special Review Committee on FINRA's Examination Program in Light of the Stanford and Madoff Schemes, (Sept. 2009) ("Report of the 2009 Special Committee") at 50-56).)

Similarly, the jury must know that BLMIS was subject to oversight and audit by the IRS and New York Department of Taxation. (Cave Decl. Ex. 6 (Lundelius Rep. ¶¶ 192-194).) In particular, in 2004, the New York Department of Taxation conducted an audit of BLMIS's 2001, 2002, and 2003 tax returns. (*Id.* ¶ 192.) In 2007, the IRS conducted an audit of BLMIS's 2004 and 2005 tax returns. (*Id.*)

In their attempt to exclude this relevant evidence while admitting evidence of the SEC's similar examinations and investigations, Plaintiffs claim that the distinction is that the SEC's regulatory oversight has been the "subject of exhaustive scrutiny" and is addressed in the "comprehensive" report prepared by the SEC's Office of Inspector General. (Pls.' Mot. at 1-2.) It makes no sense that the relevance and admissibility of evidence of regulatory oversight would depend on how much "scrutiny" the regulator has received or on the scope of a report prepared

after the fact. Plaintiffs cannot have it both ways. Evidence of the entire regulatory framework applicable to BLMIS is relevant and admissible for the same reasons evidence of the SEC's oversight is.[1]

II. The Inability Of Regulators And Due Diligence Providers To Uncover Madoff's Fraud Is Relevant To Proximate Cause.

The evidence of the examinations and investigations conducted by Madoff's regulators and by KPMG is also relevant to proximate cause. In order to prevail on their negligence claim, Plaintiffs must establish that the PwC Defendants' allegedly negligent audits proximately caused their losses. *See Di Benedetto v. Pan Am World Serv.*, 359 F.3d 627, 630 (2d Cir. 2004). But there is no dispute that even a properly conducted audit may not detect a material misstatement resulting from fraud. *See* AU § 316.10; ISA § 240.13. Thus, it is not enough for Plaintiffs to prove that the PwC Defendants did not comply with the professional standards. Instead, Plaintiffs must also prove that, had the PwC Defendants conducted a proper audit of the Funds, they would have, as Plaintiffs argue, discovered Madoff's fraud because they would have learned that no assets existed. (SCAC ¶ 313 ("Had PwC performed appropriate audits (as it represented it had), it would have learned that the securities transactions purportedly conducted by Madoff did not occur and the assets of the Funds did not exist.").)

The inability of government regulators and due diligence providers who were specifically tasked with examining BLMIS and evaluating fraud risks[2] to discover that Madoff did not

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1. In any event, like the SEC, FINRA also conducted a special investigation of its examinations of BLMIS, including interviews and review of relevant documents, and also issued a report of its findings. (Cave Decl. Ex. 7 (Report of the 2009 Special Committee at 1).) While Plaintiffs unfavorably comment on the number of pages and citations in the FINRA report (Pls.' Mot. at 4 n.3), such quibbling provides no basis to exclude evidence of FINRA's oversight.

2. (*See, e.g.*, Cave Decl. Ex. 8 ("Review of fraud and related operational risks at Bernard L Madoff Investment Securities LLC," KPMG LLP (Sept. 8, 2008) at 2 ("The purpose of the engagement was to assist HSBC to identify the fraud risks that may arise as a result of HSBC . . . placing the funds of [its clients] with Bernard L Madoff Investment Securities LLC . . . .")).)

actually have the assets he claimed he did is relevant to the question of whether an appropriate audit of the financial statements of the Funds – not of BLMIS – could reasonably have been expected to do so. *See Meridian Horizon Fund LP v. KPMG (Cayman)*, 487 F. App'x 636, 641 (2d Cir. 2012) (affirming dismissal of claims against auditor where alleged red flags "were not only plainly disclosed to plaintiffs in the Tremont offering materials, but also to, *inter alios*, investors in and auditors of other Madoff feeder funds, and the SEC, none of whom discovered the Madoff scheme").

This is especially true because Plaintiffs and their expert claim that one of the procedures that the PwC Defendants could have performed that would have resulted in the revelation of the fraud was inspecting the workpapers of BLMIS's auditor, Friehling & Horowitz, to determine if it had third-party evidence of the existence of assets held by Madoff. (Cave Decl. Ex. 1 (Carmichael Rep. at 15, 154-56).) But when BLMIS was audited by the IRS, BLMIS employees and Friehling & Horowitz conspired to create false records to deceive the IRS auditors. (Cave Decl. Ex. 6 (Lundelius Rep. ¶¶ 193-94); Information, *United States v. Cotellessa-Pitz*, No. S5 10 Cr. 228 (LTS) (S.D.N.Y.) ¶ 44 ("In 2007, at the direction of Madoff and Friehling, ENRICA COTELLESSA-PITZ, the defendant, Daniel Bonventre, Jerome O'Hara, and other co-conspirators created a false, backdated G/L, Stock Record and false reports derived from the Stock Record for the year 2004 in order to support the false 'gross receipts' numbers on Madoff's Tax Returns.").) This evidence is relevant to Plaintiffs' assertion that the PwC Defendants could have prevented Plaintiffs' losses by asking to review the Friehling & Horowitz workpapers.

III. The Probative Value Of The Evidence Is Not Substantially Outweighed By The Danger Of Unfair Prejudice Or Confusion Of The Issues.

Plaintiffs also claim that the evidence of oversight and examinations, other than those conducted by the SEC, should be excluded under Rule 403 because there will be a need to conduct "mini-trials" to determine the adequacy of each inquiry. (Pls.' Mot. at 4.) This is not the case.

Just as there is no need to conduct a "mini-trial" to determine the adequacy of the SEC's investigations and examinations, which Plaintiffs agree should be admitted, there is no need to conduct a trial of the adequacy of the work of every other regulator or KPMG. The question is not whether FINRA, the tax authorities, or KPMG (or the SEC for that matter) could or should have done a better job. Instead, all that matters is that these entities exercised regulatory oversight over BLMIS (or, in the case of KPMG, performed a due diligence investigation into BLMIS) – facts that can be shown through a handful of exhibits and brief testimony.

Plaintiffs' reliance on *Park West Radiology v. CareCore National LLC*, 675 F. Supp. 2d 314 (S.D.N.Y. 2009), is therefore misplaced. Unlike here, in that case, the party seeking admission of the evidence planned to argue that the non-parties engaged in fraud and other misconduct, leading the Court to exclude the evidence as it would have led to the need to a "sideshow" to determine the merits of the allegations raised against each non-party. *See Park W. Radiology v. CareCore Nat'l LLC*, 547 F. Supp. 2d 320, 322 (S.D.N.Y. 2008) ("Moreover, unless such persons are formally named and brought within the Court's jurisdiction, this lawsuit is hardly the forum to resolve the accusations Defendants make against them.").[3] No such trial of the regulators' performance is required here.

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3. Similarly inapposite is *In re Seroquel Products Liability Litigation*, 601 F. Supp. 2d 1313 (M.D. Fla. 2009). There, in a pharmaceutical products liability case, the court excluded evidence that foreign regulators had forced the defendant to make label changes and took other regulatory actions in those jurisdictions. *Id.*at 1316.

CONCLUSION

For the foregoing reasons, Plaintiffs' Motion *in Limine* No. 2 should be denied.

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