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. 3 TO EXCLUDE DECISIONS REACHED IN OTHER CASES OR PROCEEDINGS

FILED UNDER SEAL PURSUANT TO CONFIDENTIALITY ORDER

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Defendants PricewaterhouseCoopers Accountants N.V. ("PwC Netherlands") and PricewaterhouseCoopers LLP ("PwC Canada") (collectively, the "PwC Defendants") respectfully submit this memorandum of law in opposition to Plaintiffs' Motion *in Limine* No. 3 to exclude decisions reached in other cases or proceedings.

PRELIMINARY STATEMENT

Plaintiffs' motion seeks to exclude evidence about two types of decisions: (1) two decisions rejecting claims that PwC Netherlands' audits of the Funds did not comply with the professional auditing standards; and (2) decisions in other cases involving auditors of similarly situated Madoff funds. The jury should be allowed to consider evidence about both types of decisions.

With respect to the first category, Plaintiffs seek to exclude evidence that the Disciplinary Council of Accountants and Auditors of the Netherlands (the "Disciplinary Council") issued a decision rejecting a complaint brought by investors in the Funds against a PwC Netherlands engagement partner, Fred Gertsen, alleging that the audits he led did not comply with International Standards on Auditing ("ISA"), and that the District Court of Amsterdam (the "Dutch Court") issued a decision rejecting a similar complaint brought by investors in the Funds against PwC Netherlands alleging that its audits did not comply with ISA.

Plaintiffs' argument that these decisions lack probative value because they were based on different facts and circumstances, a different record, and a different legal standard (Pls.' Mot. at 3-4), is wrong. The Disciplinary Council and the Dutch Court addressed the exact same criticisms about the audits that Plaintiffs make here and considered whether the audits were conducted in accordance with ISA – the same issue to be resolved in this case. And the decisions were not, as Plaintiffs assert, "based on pleadings" (*id.* at 3); rather, they were reached

after consideration of exhibits, including the relevant audit workpapers, and a public hearing at which witnesses were questioned.

That does not, of course, mean that the decisions are binding on the jury, but they are plainly relevant and admissible. Among other reasons, the decisions are necessary to a proper evaluation of the reliability of the opinions offered by the Plaintiffs' audit expert, Dr. Douglas R. Carmichael. Dr. Carmichael opines that the PwC Defendants failed to comply with the professional standards because they did not perform certain procedures that he believes were necessary to verify the existence of the Funds' assets at BLMIS. But that exact same assertion about the same procedures was rejected by the Disciplinary Council – the governing body of auditors in the Netherlands – and by the Dutch Court. The PwC Defendants are entitled to cross-examine Dr. Carmichael, who has never signed an audit report, regarding this evidence, which contradicts and undermines his opinions. The evidence is similarly important to a proper evaluation of the PwC Defendants' experts and of Mr. Gertsen, who all will testify that the procedures suggested by Dr. Carmichael were not required by the professional standards, a conclusion corroborated by the decisions of the Disciplinary Council and Dutch Court.

With respect to the decisions in other Madoff-related actions, there are two ways in which the evidence is relevant, admissible, and probative. First, similar to the rationale for the Dutch Court decision, these rulings by various courts are probative evidence that the theories advanced by plaintiffs' auditing expert, Dr. Carmichael, are not consistent with Generally Accepted Auditing Standards in the United States (U.S. GAAS). Second, the decisions provide reliable evidence as to what information other auditors, similarly situated to the PwC Defendants obtained from BLMIS and what, if any, audit procedures they performed at BLMIS. As such, the PwC Defendants' experts are entitled to rely upon them, and use them at trial as evidence of

the conduct of other auditors, even if the Court determines that the decisions themselves should not be presented to the jury with respect to the legal rulings reflected therein.

BACKGROUND OF DUTCH DECISIONS

Plaintiffs' motion reflects a misunderstanding of the issues addressed in the decisions of the Disciplinary Council and Dutch Court and the evidentiary record on which those decisions were based. The following description of the proceedings can be derived from the relevant decisions and from the anticipated testimony of Mr. Gertsen.

The Decision of the Disciplinary Council

In the Netherlands, disciplinary proceedings concerning auditors are conducted before the Disciplinary Council, which is a five-member body consisting of three appointed judges and two accountants.

In January 2011, certain investors in the Funds filed a complaint against Mr. Gertsen with the Disciplinary Council claiming that PwC Netherlands' audits of the Funds did not comply with the relevant professional standards.[1] The investors filed exhibits with their complaint and, in response, Mr. Gertsen filed a statement of defense that included as exhibits the relevant workpapers that reflected the audit work PwC Netherlands conducted with respect to the existence of the Funds' assets. The investors and Mr. Gertsen filed additional briefs and exhibits in advance of a public hearing before the Disciplinary Council that was held on July 1, 2011. (Cave Decl. Ex. 9 (Disciplinary Council Decision § 1).) During the hearing, the Disciplinary Council asked questions of Mr. Gertsen and another PwC Netherlands auditor, Chris Meijnders.

1. The investors that filed the claim were Colima International Limited and Merus Trident Trust Company Limited, and Stichting Fairfield Compensation Foundation, a Dutch entity that had been transferred the claims of over 700 other investors in the Funds. (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. 9 (Disciplinary Council Decision § 2.1).)

On January 6, 2012, the Disciplinary Council issued its decision on the merits, declaring the complaint unfounded. (*Id.* § 5.) The Disciplinary Council rejected the investors' argument that Mr. Gertsen and PwC Netherlands did not have a sufficient basis to issue their opinions on the Funds' financial statements. (*Id.* § 4.7.2.)

In light of all the evidence, the Disciplinary Council concluded that Mr. Gertsen and PwC Netherlands were entitled to rely on confirmations of the existence of assets held by BLMIS "even where these originated from B[L]MIS itself." (*Id.*) Therefore, the Disciplinary Council rejected the argument that "Gertsen should have consulted with B[L]MIS's auditor in order to obtain insight into the scope of the latter's audits" or that he should have made "inquiries with the Depository Trust Company (DTC) and the Bank of New York (BNY)." (*Id.*) With respect to the latter proposed procedure, the Disciplinary Council concluded that it "would have been pointless" because the DTC would have had no information about the Fairfield funds. There is no dispute that BLMIS had other clients besides the funds, so BLMIS client securities would have been "held as aggregated positions in the name of B[L]MIS with DTC and with BNY." (*Id.*) In reaching its conclusion, the Disciplinary Council found support in the fact that no other auditors performed the procedures that the investors claimed should have been performed by PwC Netherlands. (*Id.*)

The investors elected not to exercise their right to appeal the Disciplinary Council decision.

The Decision of the Dutch Court

Two of the same entities that filed the complaint with the Disciplinary Council (Colima and the Stichting Foundation that holds the claims of more than 700 investors) subsequently filed an action seeking damages against PwC Netherlands in the Amsterdam District Court raising the same basic claim related to the audits of the Funds. (Cave Decl. Ex. 10 (District Court

Decision).) The parties submitted comprehensive briefs and more than 75 exhibits, including the relevant workpapers reviewed by the Disciplinary Council. A hearing was held on July 3, 2014. (*Id.* § 1.1.)

On September 3, 2014, the three-judge panel of the Dutch Court rendered its judgment rejecting the investors' claim against PwC Netherlands. (*Id.* § 7.) As explained by the Dutch Court, "[t]he core of the dispute is whether PwC performed the auditing of the financial statements of the Funds in a manner that may be expected from a reasonably acting and reasonably competent external auditor." (*Id.* § 5.1.) The Dutch Court concluded that the investors had not provided any basis for the Dutch Court to disagree with the decision of the Disciplinary Council, and thus rejected the investors' argument that "PwC did not act as befits a reasonably acting and reasonably competent auditor" when auditing the Funds. (*Id.* §§ 5.4, 5.5.)

The investors have appealed the judgment of the Dutch Court to the Court of Appeal for Amsterdam.

ARGUMENT

I. The Decisions Of The Disciplinary Council And Dutch Court Regarding PwC Netherlands' Audits Of The Funds Are Relevant And Admissible.

A. The Decisions Evaluated The Same Audits Under The Same Standards That Apply Here.

As the above description of the decisions makes clear, Plaintiffs' argument that evidence of the decisions of the Disciplinary Council and Dutch Court should be excluded because the decisions were "based on different facts and circumstances" or were "based on pleadings" is simply wrong. (Pls.' Mot. at 3.) The facts and circumstances were, in fact, identical. The proceedings were initiated by investors in the Funds based on claims that the very same audits at issue here were deficient for the very same reasons.

And the decisions were not based only on "pleadings" but rather were reached after a public hearing at which witnesses were questioned and the review of dozens of exhibits, including the relevant workpapers.[2] Thus, Plaintiffs' reliance on cases standing for the proposition that "preliminary findings" are "not binding on a jury at trial" misses the mark. (Pls.' Mot. at 3-4.) The decisions were not "preliminary" and the PwC Defendants do not argue that the decisions are binding on the jury; simply that evidence of the decisions is admissible. *Cf. TVT Records v. Island Def Jam Music Grp.*, 250 F. Supp. 2d 341, 347 (S.D.N.Y. 2003) (findings at preliminary injunction hearing are not binding on the jury); *Poe v. Charlotte Mem'l Hosp., Inc.*, 374 F. Supp. 1302, 1312 (W.D.N.C. 1974) (findings in decision issuing temporary restraining order are not binding on jury).

Similarly misguided is Plaintiffs' argument that evidence of the decisions must be excluded because they involved different legal standards. (Pls.' Mot. at 4.) The standard by which the audits were evaluated in the Netherlands is the same as the standard the jury will apply here: "whether PwC performed the auditing of the financial statements of the Funds in a manner that may be expected from a reasonably acting and reasonably competent external auditor." (Cave Decl. Ex. 10 (District Court Decision § 5.1); *see* Cave Decl. Ex. 9 (Disciplinary Council Decision § 4.72).) *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

2. Plaintiffs note that the Disciplinary Council issued its decision without reviewing the entire PwC Netherlands audit file. (Cave Decl. Ex. 9 (Disciplinary Council Decision § 4.7.3).) But that is because, as the Dutch Court observed, there was no dispute that PwC Netherlands did not perform the procedures that the investors there (and Plaintiffs here) claim were required and therefore inspection of the entire audit file was unnecessary to determine the claim. (Cave Decl. Ex. 10 (District Court Decision § 6.1).)

professional guidelines, with the appropriate reasonable, honest judgment that a reasonably skillful and prudent auditor would use under the same or similar circumstances").[3]

B. The Decisions Are Critical Impeachment Evidence.

Plaintiffs ignore the PwC Defendants' rights to cross-examine Plaintiffs' audit expert about matters that impeach his opinions and to the jury's consideration of the applicable standard of care.

Dr. Carmichael has opined that the professional standards required an auditor of a fund with substantially all its assets at BLMIS to perform certain procedures: either independently verify with the Bank of New York or Depository Trust Company the existence of assets held by BLMIS or, alternatively, review the work performed by BLMIS's auditor. (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).) According to Dr. Carmichael, no reasonable auditor could have issued an unqualified opinion in similar circumstances without performing one of these procedures. (Cave Decl. Ex. 3 (Carmichael Tr. 97:17-24).)

As discussed above, this opinion was directly rejected by the Disciplinary Council and the Dutch Court. The PwC Defendants must be permitted to confront Dr. Carmichael with evidence of this rejection of his opinions. Indeed, as explained more fully in the PwC Defendants Opposition to Plaintiffs' Motion *in Limine* No. 1, Dr. Carmichael's only basis for his opinions is his say-so. He has no actual experience in performing audits of investment funds, no other auditor of a similarly situated fund interpreted the standards as he does, and the

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3. Thus, Plaintiffs' complaint that the PwC Defendants' experts are not qualified to describe the "different legal standards and concepts that applied in these other proceedings" is without merit. (Pls.' Mot. at 5.) The expert and fact witnesses will discuss whether the audits were conducted in accordance with ISA; they will not be called upon to discuss their view of the law, either in New York or the Netherlands. *Cf. Ebbert v. Nassau Cnty.*, No. CV 05-5445 (FB) (AKT), 2008 WL 4443238, at *7 (E.D.N.Y. Sept. 26, 2008) (striking portions of expert report offering legal conclusions).

interpretation of the standards in the governing professional literature is also contrary to Dr. Carmichael's view. The PwC Defendants must be permitted to establish through cross-examination that Dr. Carmichael's opinion has also been rejected by the governing body of accountants in the Netherlands.

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. *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."). The PwC Defendants must be afforded the ability to attack Dr. Carmichael's opinions by conducting meaningful cross-examination, the "traditional and appropriate means of attacking shaky but admissible evidence." *Daubert v. Merrell Dow Pharm.*, 509 U.S. 579, 596 (1993). Prohibiting cross-examination of Dr. Carmichael on the rejection of his opinions by the Disciplinary Council and Dutch Court would deprive the PwC Defendants of this fundamental right.

Exclusion of this evidence would also unfairly restrict the jury's consideration of evidence relevant to determining the appropriate standard of care. Fred Gertsen, the PwC Netherlands audit partner who was vindicated in the Disciplinary Council decision, and the PwC Defendants' audit experts will all testify that the procedures identified by Dr. Carmichael were not required by the applicable standard of care. This conclusion is corroborated by, among other things, the similar conclusion reached by the Disciplinary Council and Dutch Court. The jury is

entitled to consider this evidence in evaluating the testimony of Mr. Gertsen and the PwC Defendants' experts and weighing that against Dr. Carmichael's beliefs.[4]

C. Rule 403 Does Not Justify Exclusion Of The Evidence.

Nor is there any basis to exclude evidence of the decisions under Rule 403. (Pls.' Mot. at 4-5.) These decisions are highly probative to critical issues in the case – the basis for the opinions of the parties' experts and the relevant standard of care. The PwC Defendants do not seek to admit evidence of the decisions as binding on the jury's determination of any issue and any concern that might exist in that regard can be dealt with through an appropriate instruction. *See* Fed. R. Evid. 105. There is no basis to find that the risk of confusion substantially outweighs the probative value of the evidence.

Finally, Plaintiffs' objection to the introduction of the actual decisions is no basis for exclusion of any evidence about the decisions. (Pls.' Mot. at 6-7.) The PwC Defendants do not seek to place lengthy legal decisions in evidence and ask the jury to "decode them." *Hart v. RCI Hospitality Holdings, Inc.*, 90 F. Supp. 3d 250, 276-277 (S.D.N.Y. 2015). But, whether the text of the decisions is admitted or not, the PwC Defendants are entitled to introduce evidence of the fact that the Disciplinary Council and Dutch Court rendered decisions rejecting the argument that the procedures identified by Dr. Carmichael were required by the professional standards.

II. The Other Decisions Are Also Admissible.

As the Court is well aware, the Madoff fraud spawned a number of legal proceedings. In some of those proceedings, the public record evidences certain facts as to the audit work performed by other firms auditing funds with investments held by BLMIS. The PwC

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4. The Court can, of course, take judicial notice of the decisions and their contents, even where the truth of the statements in the decisions is subject to dispute. *See A.I. Trade Fin., Inc. v. Centro Internationale Handelsbank AG*, 926 F. Supp. 378, 387 (S.D.N.Y. 1996) (citing *United States v. Garland*, 991 F.2d 328, 335 (6th Cir. 1993)).

Defendants' experts have reviewed and relied upon these documents in forming their opinions that none of the other dozens of auditors similarly situated to the PwC Defendants obtained more information from, or performed any more extensive audit procedures at, BLMIS than did the PwC Defendants. This fact is a critical component of the PwC Defendants' evidence that shows, contrary to Plaintiffs' claims, that their work complied with applicable professional standards, ISA and U.S. GAAS in the case of PwC Netherlands and U.S. GAAS in the case of PwC Canada.

One example of the documents Plaintiffs seek to exclude from evidence is the Arbitration Award in *KPMG LLP v. Eastham Capital Appreciation Fund L.P., et al.*, No. 654139-2013, 2013 WL 7018202 (N.Y. Sup. Ct. Aug. 21, 2013) (the "*KPMG* Decision"). This proceeding arose from audits performed by KPMG LLP (the U.S. firm) of the financial statements of the Rye funds. *Id.* at 3. The Rye funds, like the Fairfield Greenwich Group ("FGG") funds, participated in the exact same "split-strike conversion" in which BLMIS purported to initiate purchases and sales of securities based on its proprietary method, execute those transactions as an SEC-registered broker-dealer, and hold custody of significant portions of the various funds' assets. Indeed, the Rye funds and the FGG funds would share in pro rata allocations of the same trades reported by BLMIS for all of its split-strike fund clients.

The *KPMG* Decision recounts the audit procedures undertaken by KPMG with respect to BLMIS and reveals, essentially, that KPMG confirmed the existence of the assets with BLMIS but did not seek any additional information from BLMIS with respect to its operations or controls. *Id.* at 3. KPMG defended against the claims against it by arguing it was not required to do more under U.S. GAAS. *Id.* at 3-4. The Panel agreed, finding that the issue of whether the auditing standards required KPMG to do additional audit work was "unquestionably a judgment

call," *id.* at 4, and that the plaintiffs had failed to present any evidence showing that KPMG's decision to not perform additional work was not what a "reasonably skillful and diligent accountant[] would do under circumstances like those of the 2007 Rye funds audit [or] that any other audit of a Madoff investor ever resulted in a qualified opinion." *Id.* at 4.

The *KPMG* decision is relevant and highly probative here for three reasons: first, it confirms that Plaintiffs have the burden to show that the PwC Defendants acted as no reasonable auditor would have under the circumstances. Second, it evidences that KPMG performed significantly fewer audit procedures than the PwC Defendants. The PwC Defendants, in addition to confirming the assets held by BLMIS as KPMG did, visited BLMIS and made inquiries of Madoff and other personnel to gain an understanding of its key internal controls and also gathered evidence of the effective operation of those key controls via a review of BLMIS's SEC Rule 17a-5 Report on Internal Controls and its audited Statement of Financial Condition. Third, it explains that plaintiffs failed to prove KPMG was negligent, and is thus probative evidence that the PwC Defendants exercised their professional judgment in a manner consistent with other professionals (and, indeed, forms part of the evidence that shows ***no*** fund auditor took the approach advocated by Plaintiffs here), and was therefore not held to have violated applicable professional standards.

Even if the Court were to conclude that it would be confusing to the jury or prejudicial to Plaintiffs' case for the jury to be shown the *KPMG* decision, the PwC Defendants should nevertheless be allowed to rely on it – and other similar documents from various proceedings – to show the facts concerning work done by other audit professionals and how the PwC Defendants audit work was consistent with, or exceeded, that audit work, and that no other fund auditor took the approach advocated by the Plaintiffs.

CONCLUSION

For the foregoing reasons, Plaintiffs' Motion *in Limine* No. 3 should be denied.

Dated: New York, New York
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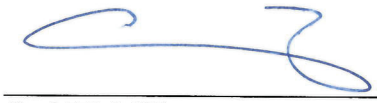

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