UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

ANWAR, *et al.*,

Plaintiff,

v.

FAIRFIELD GREENWICH LIMITED, *et al*.,

Defendants.

This Document Relates To: All Actions

No. 09 CV 118 (VM)

Judge Victor Marrero

ORAL ARGUMENT REQUESTED

REPLY MEMORANDUM OF LAW OF DEFENDANT PRICEWATERHOUSECOOPERS ACCOUNTANTS N.V. IN FURTHER SUPPORT OF ITS MOTION TO DISMISS

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STATUTES AND RULES

Defendant PricewaterhouseCoopers Accountants N.V. ("PwC Netherlands") respectfully submits this reply memorandum of law in response to Plaintiffs' Consolidated Opposition To The PwC Defendants' Motions To Dismiss ("Pl. Opp. PwC" or "Opposition") and in further support of its motion to dismiss the Second Consolidated Amended Complaint (the "Complaint").

Argument

The Opposition concedes that plaintiffs are not trying to plead scienter based on a theory that PwC Netherlands either "participated in or failed to uncover" the fraud. (Pl. Opp. PwC 17.) Indeed, the Complaint fails to plead anything remotely "approximat[ing] an actual intent to aid in the fraud," which is the standard for pleading fraud against an auditor. *Rothman v. Gregor*, 220 F.3d 81, 98 (2d Cir. 2000). Beyond labels ("severely reckless" and "willful blindness"), the Opposition offers nothing more than allegations of negligence and the same allegations of "red flags" that Judge Griesa already held insufficient in *In re Tremont Securities Law, State Law & Insurance Litigation*, No. 08 Civ. 11117, 2010 WL 1257580, at *5 (S.D.N.Y. Mar. 30, 2010), and *Meridian Horizon Fund, LP v. Tremont Group Holdings, Inc.*, No. 09 Civ. 3708, 2010 WL 1257567, at *6 (S.D.N.Y. Mar. 31, 2010), and that Judge Holwell held insufficient in *Stephenson v. Citco Group Ltd.*, No. 09 CV 00716, 2010 WL 1244007, at *19-20 (S.D.N.Y. Apr. 1, 2010). Similarly, the state law claims are either insufficiently pleaded, untimely, preempted, or all three, and the Opposition does not demonstrate otherwise.

I. THE COMPLAINT FAILS TO ALLEGE SCIENTER AGAINST PwC NETHERLANDS.

All that the Opposition offers to try to satisfy plaintiffs' pleading burden as to PwC Netherlands' scienter is (a) group pleading; (b) so-called "red flag" allegations; and (c) alleged violations of professional standards.

A. The Opposition Relies On Impermissible Group Pleading.

The Opposition makes no attempt to justify the Complaint's reliance on impermissible group pleading against PwC Netherlands. (*See* Pl. Opp. PwC 1 n.2 (collectively referring to PwC Netherlands and two other defendants as "PwC"), *see also id.* at 5, 6, 8.)

B. The Allegations Of "Red Flags" Are Insufficient.

The Opposition acknowledges the need to show that PwC Netherlands "knew facts or had access to information suggesting [its] public statements were not accurate," but fails to point to any allegation that PwC Netherlands was aware of either Madoff's fraud or plaintiffs' purported list of "red flags." (Pl. Opp. PwC 10.) As in *The Limited*, *Inc. v. McCrory Corp.*, 683 F. Supp. 387, 394 (S.D.N.Y. 1988), allegations that lack any "indication of how or when [the auditor] became aware of facts that made the financial statements materially misleading" are "legally insufficient" and unable to "rise above the level of negligence."[1]

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1. Not only are the purported "red flag" allegations insufficient, many do not even apply to PwC Netherlands. The Opposition points to wholly innocuous "interviews [with] and visits" to Madoff, which the Complaint does not allege that anyone from PwC Netherlands ever attended (s*ee* Pl. Opp. PwC 12-13; *see also* Compl. ¶¶ 271-73), and to documents that post-date the 2005 audit, PwC Netherlands' last audit. (*See* ¶¶ 276 ("Audit Plan" was "a report to the [FGG] on its [plan] for the year ending December 31, 2008"); 292 ("PwC Guide" was issued in 2007); 294 (2008 Global Annual Review); *see also* 292-94; 306; 307-09.)

   The Opposition's reliance on cases where the auditor "was aware" of serious internal problems at its client, (Pl. Opp. PwC 14), is misplaced because there is no allegation here that PwC Netherlands was aware of facts indicating serious problems at its client funds nor any allegation that the firm ever audited Madoff's business. *See Varghese v. China Shenghuo Pharm. Holdings, Inc.*, 672 F. Supp. 2d 596, 602 (S.D.N.Y. 2009) (sustaining claims against auditor who was aware that its client publicly admitted having "significant deficiencies" that caused its internal accounting controls to be ineffective); *In re IMAX Sec. Litig.*, 587 F. Supp. 2d 471, 484-85 (S.D.N.Y. 2008) (sustaining claims against auditor who knew about regulators' concerns about client's revenue recognition policy, was "extensively involved in the process by which [that policy] developed and evolved," and thus was not a "typical outside auditor").

Judge Griesa recently held that the same "red flag" allegations were insufficient because they failed to "allege that the [a]uditors were aware of any facts indicative of Madoff's fraud that they consciously disregarded." *Tremont*, 2010 WL 1257580, at *5; *see also Meridian*, 2010 WL 1257567, at *6. In *Stephenson*, Judge Holwell similarly held that the "red flag" of Madoff's dual roles as trader and custodian was "far too mild to support" an inference of recklessness by an auditor who did not audit Madoff's business. 2010 WL 1244007, at *20. Both Judge Griesa and Judge Holwell noted as a critical fact in each case that the auditors "were never engaged to audit Madoff's businesses or to issue an opinion on the financial statements of BMIS." *Tremont*, 2010 WL 1257580, at *6; *see Stephenson*, 2010 WL 1244007, at *20. The same is true here: there is no allegation that PwC Netherlands was ever engaged to audit Madoff's businesses.

C. Allegations Of GAAS Violations Are Insufficient.

The Opposition concedes that GAAS violations alone are insufficient. (*See* Pl. Opp. PwC 14.) Indeed, it is well-settled that "alleging a shoddy audit in violation of GAAS does not establish the intent to defraud required to maintain a claim for securities fraud." *Tremont*, 2010 WL 1257580, at *5. Particularly flawed are those allegations that relate primarily to Madoff, rather than to PwC Netherlands' clients. As Judge Griesa held in *Meridian*, the "notion that a firm hired to audit the financial statements of one client (the XL Funds) must conduct audit procedures on a third party that is not an audit client (BMIS) on whose financial statements the audit firm expresses no opinion is unprecedented and has no basis." 2010 WL 1257567, at *6.[2]

2. The Opposition's cases involved specific factual allegations indicating that the auditor was aware of the fraud. (*See* Pl. Opp. PwC 14.) For example, in *In re New Century*, 588 F. Supp. 2d 1206, 1234 (C.D. Cal. 2008), the auditor identified accounting deficiencies but failed to correct them and had evidence contradicting its client's representations, and in *Whalen v. Hibernia Foods PLC*, No. 04 Civ 3182, 2005 WL 1799370, at *4 (S.D.N.Y. Aug. 1, 2005), the auditor knew from speaking to its client's employees and from the fact that the auditor's

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D. The More Compelling Inference Is That PwC Netherlands Did Not Have Fraudulent Intent.

The Opposition fails even to acknowledge what Judge Griesa found to be the "more compelling inference as to why Madoff's fraud went undetected for two decades," that is, Madoff's "proficiency in covering up his scheme and eluding the SEC and other financial professionals." *Tremont*, 2010 WL 1257580, at *5. (*See* Pl. Opp. PwC 17.) Madoff's proficiency is confirmed by the recent indictment of the executive who served as Madoff's Director of Operations for over 30 years. That indictment discloses how this Director, along with Madoff's information and technology employees, created special computer programs to generate seemingly authentic back-up support for Madoff's fraudulent scheme. (Declaration of Gabrielle S. Marshall ("Marshall Decl.") Ex. A, ¶¶ 25-26, 34, 49.)

II. THE FEDERAL SECURITIES LAW CLAIM AGAINST PwC NETHERLANDS BASED ON ITS 2002 AUDIT REPORT IS UNTIMELY.

The Supreme Court recently noted that the statute of repose, 28 U.S.C. § 1658(b)(2), represents an "unqualified bar" to federal securities fraud claims brought more than five years after the conduct giving rise to the alleged violation. *Merck & Co. v. Reynolds*, No. 08-905, 2010 WL 1655827, at *13 (Apr. 27, 2010). The statute thereby provides a defendant "total repose after five years." *Id*. The Opposition's argument that the repose period runs from the date of plaintiffs' investments rather than the date of a defendant's conduct in making the

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own fees were not paid that the client's financial condition was dire. In *In re Winstar Communications*, No. 01 CV 3014, 2006 WL 473885, at *12 (S.D.N.Y. Feb. 27, 2006), the auditor knew about the bogus transactions because it had "devised" how to account for them, although the court noted that — as is the case here — had the pleading alleged that the insiders "took action to conceal" the fraud, and that the auditors "failed to detect and disclose [it], scienter would not be established."

statement, (Pl. Opp. PwC 22), is inconsistent with the plain words of the statute and the weight of authority.[3]

Nor can the statute of repose be circumvented just because a statement was later repeated. (*See* Pl. Opp. PwC 22-23.) Contrary to the Opposition, district courts in this Circuit have found that "[i]t is not at all clear" that the so-called "continuing fraud doctrine" applies in securities fraud cases, *de la Fuente v. DCI Telecomm, Inc.*, 206 F.R.D. 369, 385 (S.D.N.Y. 2002), and have noted that, in fact, the "weight of authority . . . is skeptical of the application of the continuing violations doctrine in securities fraud cases." *Comverse*, 543 F. Supp. 2d at 155.

III. THE STATE LAW CLAIMS FAIL AS A MATTER OF LAW.[4]

A. The State Law Claims Should Be Dismissed Under Rule 9(b).

The Opposition concedes that heightened pleading standards apply to claims based on allegations of fraud. (*See* Pl. Opp. PwC 23, nn.21, 22.) All of the state law claims incorporate and reallege fraud allegations. (Memorandum of Law of Defendant PricewaterhouseCoopers Accountants N.V. in Support of Its Motion to Dismiss the Second Amended Consolidated Complaint ("PwC Netherlands' Br.") 16.) Accordingly, they should be dismissed under

3. *See In re Comverse Tech., Inc. Sec. Litig.*, 543 F. Supp. 2d 134, 155 (E.D.N.Y. 2008) (finding that for claim based on misrepresentation, five year repose period runs from date of misrepresentation); *Malhotra v. Equitable Life Assurance Soc'y of the U.S.*, 364 F. Supp. 2d 299, 305-06 (E.D.N.Y. 2005) (collecting cases and holding that statute of repose period runs from the date of the alleged misrepresentation or omission). The Opposition's cases do not require otherwise. (Pl. Opp. PwC 22.) In *In re Gilat Satellite Networks, Ltd.*, No. CV-02-1510, 2005 WL 2277476, at *23 (E.D.N.Y. Sept. 19, 2005), the court did not address this issue other than in *dictum* and instead analyzed the timeliness of later filed claims under a relation back theory. Similarly, the court in *Shalam v. KPMG LLP*, No. 05 CV 3602, 2005 WL 2139928, at *3 (S.D.N.Y. Sept. 6, 2005), merely decided that defendants' later misconduct did not bear on when the statutory period began.

4. PwC Netherlands also joins the argument that plaintiffs lack standing to assert all state law claims. (Reply Memorandum in Support of PricewaterhouseCoopers LLP's Motion to Dismiss ("PwC Canada Reply") 4-6.)

Rule 9(b) for failure to plead fraud with particularity. *See Rombach v. Chang*, 355 F.3d 164, 172 (2d Cir. 2004).

B. The Unjust Enrichment Claim Should Be Dismissed.

The Opposition does not contest PwC Netherlands' arguments as to the insufficiency of the unjust enrichment claim, which should therefore be dismissed. (PwC Netherlands' Br. 23.)

C. The Negligence Claims Should Be Dismissed For Lack of Privity.

To try to assert a "near privity" relationship, the Complaint and the Opposition rely on the assertion that PwC Netherlands "addressed" or "directed" its audit reports to "shareholders." (*See* Pl. Opp. PwC 25, 27, 28, 31, 34.) This is insufficient. While PwC Netherlands provided reports to its client funds, there is no allegation that the firm knew about any particular potential investor, much less that any such investor intended to use one of the firm's reports for the specific purposes of deciding whether to make an investment in the funds. Further, there can be no "linking conduct" under *Credit Alliance Corp. v. Arthur Andersen & Co.*, 65 N.Y.2d 536 (1985), because there was no "direct contact" or "substantive communication" between any plaintiff and PwC Netherlands. *See Sec. Investor Prot. Corp. v. BDO Seidman, LLP*, 222 F.3d 63, 75 (2d Cir. 2000) (quotation omitted). Thus, plaintiffs' allegations are far weaker than those held insufficient in *CRT Investments, Ltd. v. J. Ezra Merkin*, No. 601052, slip op. at 21-22 (N.Y. Sup. Ct. May 5, 2010) (Marshall Decl. Ex. B), where allegations that the audited financial statements were "addressed to plaintiffs as investors" or that the auditor knew that "investors would rely upon the information contained in the financial statements" did not give rise to a duty on the part of the auditor.[5]

5. The Opposition relies on cases that are clearly distinguishable. In *Cromer Finance Ltd. v. Berger*, No. 00 Civ. 2284, 2003 WL 21436164, at *12 (S.D.N.Y. June 23, 2003), the auditor

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D. The Complaint Fails To State A Claim Against PwC Netherlands For Third Party Breach Of Contract.

The Opposition fails to cite any case holding that investors were "intended beneficiaries" of contracts between an auditor and its client where the auditor's reports were addressed to its client's shareholders. (Pl. Opp. PwC 36.) It is the parties' contract that determines whether a third party is an intended beneficiary, and in the case on which the Opposition relies, *Subaru Distributors Corp. v. Subaru of America, Inc.*, 425 F.3d 119, 125 (2d Cir. 2005), the Second Circuit affirmed the dismissal of a third party beneficiary claim because the contract's language included clauses that "set forth the functions and responsibilities" of the signatories, thus demonstrating that the contract was *not* intended "to concern and to benefit" plaintiff. Here, the engagement letter includes similar clauses and the Opposition does not discuss PwC Netherlands' contract, much less identify any term of the contract that suggested any intended

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actually "made copies" of its audit reports for the purpose of having the reports "distributed" to the shareholders or their advisors. In *AUSA Life Insurance Co. v. Ernst & Young*, 206 F.3d 202, 223 (2d Cir. 2000), unlike here, each certificate prepared by the auditor "specifically recited the names of the [plaintiff] noteholders that were entitled to 'use' and rely on [the auditor's] certification." *See also Barrett v. Freifeld*, 64 A.D.3d 736, 738 (2d Dep't 2009) (finding near privity where auditor knew plaintiff was intended buyer of its client's business); *Dinerstein v. Anchin, Block & Anchin LLP*, 41 A.D.3d 167 (1st Dep't 2007) (finding near privity because auditor knew that plaintiff had extended personal guaranty of audit client's bank loan); *White v. Guarente*, 43 N.Y.2d 356 (1977) (finding "privity" where auditor prepared tax return for limited partnership, as required by partnership agreement, for limited partners to use to prepare individual tax returns). Similarly, plaintiffs are not a "small particularized class" as existed in *Duke v. Touche Ross & Co.*, 765 F. Supp. 69, 74, 77 (S.D.N.Y 1991), where the auditor "vouched for the good judgment of the partners," went "beyond giving typical accounting advice," prepared a favorable tax opinion, and "solicited" investors.

third party benefit. (*See* Pl. Opp. PwC 38 n.28; Declaration of Howard L. Vickery ("Vickery Decl.") Ex. 12.)[6]

E. The Complaint Fails To State A Claim For Aiding And Abetting And Gross Negligence.

The Opposition concedes that the claims for aiding and abetting and for gross negligence must be pled with particularity. (Pl. Opp. PwC 23 n.22, 44.) Accordingly, these claims should be dismissed.[7]

F. The State Law Claims Are Time Barred.

To avoid the three-year statute of limitations, the Opposition invokes and relies on a single sentence in PwC Netherlands' engagement letter — "this engagement is also effective for years subsequent to 2005, until it is replaced by a new engagement letter, unless the engagement is terminated," which is what happened that same year. (*See id*. at 45.) That termination cut off any continuous representation, even if that were otherwise a viable theory. Indeed, New York courts have held that an ongoing professional relationship is not in itself a "continuous representation." *See Williamson ex rel. Lipper Convertibles, L.P. v. PricewaterhouseCoopers*

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6. Also inapposite are *Flickinger v. Harold C. Brown, Inc*., 947 F.2d 595, 600 (2d Cir. 1991) (Pl. Opp PwC 38), where the defendant's performance of the contract for brokerage clearing services could be accomplished only through the delivery of shares "directly" to the plaintiff, and *Department of Economic Development v. Arthur Andersen & Co.*, 924 F. Supp. 449, 481-82 (S.D.N.Y. 1996), where the auditor was told later at a meeting attended by plaintiff's representative that plaintiff would use the auditor's reports to satisfy a pre-condition of a loan to the auditor's client their contractual requirements.

7. The Opposition relies on readily distinguishable cases involving defendants who knew about the fraudulent scheme. (Pl. Opp. PwC 41, 43.) *See Pension Comm. of Univ. of Montreal v. Banc of America Sec., LLC*, No. 05 Civ. 9016, 2007 WL 528703, at *5, 7 (S.D.N.Y. Feb. 20, 2007) (incriminating emails evidenced defendants' "actual knowledge"); *OSRecovery*, *Inc. v. One Group Int'l., Inc.*, 354 F. Supp. 2d 357, 378 (S.D.N.Y. 2005) (finding "strong inference of actual knowledge" where defendant worked with fraudsters "after the scheme started suspiciously to fall apart" and lied repeatedly about his involvement).

LLP, 9 N.Y.3d 1, 9 (2007); *Serino v. Lipper*, 47 A.D.3d 70, 76 (1st Dep't 2007).

Even apart from the termination, the continuous representation theory could not apply here because the parties agreed that any work related to subsequent publication of PwC Netherlands' reports would "be a separate engagement and subject to a separate engagement contract." (*See* Vickery Decl., Ex. 12 at 4.) *See also Apple Bank for Sav. v. PricewaterhouseCoopers LLP*, No. 603492/06, 2008 WL 498225, at *3 (N.Y. Sup. Ct. Feb. 5, 2008) (rejecting continuous representation doctrine where engagement letter stated that "[a]ny additional services . . . will be the subject of separate written agreements"). Accordingly, the state law claims as to reports issued for fiscal years 2002, 2003, and 2004 are time-barred.

IV. THE REMAINING STATE LAW CLAIMS ARE PREEMPTED.

A. SLUSA Preempts The State Law Claims.

The argument that the Complaint has not alleged any fraud "in connection with the purchase or sale of a covered security," (*see* Plaintiffs' Consolidated Opposition to the Fairfield Greenwich Defendants' Motion to Dismiss ("Pl. Opp. FGG") 84), ignores several paragraphs of the pleading that affirmatively allege that investments were based on the use of covered securities in Madoff's purported "split-strike conversion strategy." (*See* ¶¶ 182, 184, 191, 195.) As in *Backus v. Connecticut Community Bank, N.A.*, No. 3:09 CV 1256, 2009 WL 5184360 (D. Conn. Dec. 23, 2009), the "securities fraudulently represented to be bought and sold [were] covered securities," are at the "heart" of the case — that is "the purchase and sale of securities by Madoff for the benefit of the account holders." *Id*. at *1, 5-6; *see Barron v. Igolnikov*, No. 09 Civ 4471, 2010 WL 882890, at *5 (S.D.N.Y. Mar. 10, 2010) (SLUSA preempted fund investors' claims where "fraudulent scheme was in connection with the trading in the nationally listed securities in which Madoff claimed to be engaged").

Unlike *Pension Committee of University of Montreal v. Banc of America Securities LLC*, No. 05 Civ. 9016, 2010 WL 546964, at *3, n.27 (S.D.N.Y. Feb. 16, 2010), (Pl. Opp. FGG 90-91), where the plaintiffs did not "deposit[] their money in the bank for the purpose of purchasing covered securities," here, the Complaint pleads that the only reason plaintiffs invested in the funds was to reap the returns from Madoff's investment strategy. (*See* ¶¶ 182, 184, 191, 195.)

B. The Martin Act Preempts The Non-Fraud Claims.

The weight of authority, including the opinions of Judge Griesa and Judge Holwell, holds that the Martin Act preempts private rights of action. *See Stephenson*, 2010 WL 1244007, at *13; *Tremont*, 2010 WL 1257580, at *6; *Meridian*, 2010 WL 1257567, at *7; *CRT*, slip op. at 9.

Conclusion

For the reasons set forth above, the Complaint against PwC Netherlands should be dismissed in its entirety with prejudice.

Dated: New York, New York
May 21, 2010

Respectfully submitted,

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