UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
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ANWAR, et al.,

Plaintiffs,

-against-

FAIRFIELD GREENWICH LIMITED, et al.,

Defendants.

MASTER FILE NO.
09-CV-0118 (VM)

This Document Relates To: All Actions

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REPLY MEMORANDUM OF LAW IN SUPPORT OF DEFENDANTS CITCO FUND SERVICES (EUROPE) B.V. AND CITCO (CANADA) INC.'S MOTION TO DISMISS THE SECOND CONSOLIDATED AMENDED COMPLAINT

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INTRODUCTION

While the authorities cited in CFSE and CCI's Opening Memorandum[1] are more than sufficient to warrant dismissal of Plaintiffs' claims, a series of subsequent decisions in various Madoff-related lawsuits demonstrate even more forcefully why all of Plaintiffs' claims – whether based on federal or state law – should be dismissed. These recent decisions dismissed the very types of claims asserted by the *Anwar* Plaintiffs pursuant to many of the same grounds for dismissal advanced by CFSE and CCI in their Opening Memorandum. For the reasons set forth below, all of the claims against CFSE and CCI should be dismissed with prejudice.

ARGUMENT

I. Plaintiffs Fail to State a Claim Under Section 10(b) and Rule 10b-5

A. The Allegations of the SCAC Do Not Establish *Scienter*

In their Opposition, Plaintiffs argue that they have satisfied the *scienter* requirement by alleging that CFSE and CCI "had access to information suggesting that [the Funds' NAV statements] were not accurate." (Pl. Opp. at 41.) But courts have consistently rejected Plaintiffs' "access to information" theory to establish *scienter*. *See Meridian Horizon Fund, LP v. Tremont Group Holdings, Inc.*, No. 09 Civ. 3708 (TPG), 2010 WL 1257567, at *5 (S.D.N.Y. Mar. 31, 2010) (in Madoff-related litigation, court held that "merely alleging that the [defendant] had access to the information by which it could have discovered the fraud is not sufficient.") (citing *Rothman v. Gregor*, 220 F.3d 81, 98 (2d Cir. 2000)). In short, a defendant's alleged access to

[1] "Opening Memorandum" refers to the Memorandum of Law in Support of Defendants Citco Fund Services (Europe) B.V. and Citco (Canada) Inc.'s Motion to Dismiss the Second Consolidated Amended Complaint (D.E. 330). "Plaintiffs' Opposition" or "Pl. Opp." refers to Plaintiffs' Memorandum in Opposition to the Motions to Dismiss by the Citco Defendants, Pilgrim and Francoeur (D.E. 420). "FGG's Opening Memorandum" refers to the Memorandum of Law in Support of the Motion to Dismiss the Second Consolidated Amended Complaint on Behalf of the FGG Defendants (D.E. 364). "Plaintiffs' Opp. (FGG)" refers to Plaintiffs' Consolidated Opposition to the Fairfield Greenwich Defendants' Motions to Dismiss (D.E. 418).

information does not support an inference that it knew and chose to ignore facts indicative of fraud. *Id.* (citing *In re aaiPharma Inc. Sec. Litig.*, 521 F. Supp. 2d 507, 513 (E.D.N.C. 2007)); *see also South Cherry St., LLC v. Hennessee Group LLC*, 573 F.3d 98, 110-13 (2d Cir. 2009) (mere failure to conduct due diligence – even where a defendant has a duty to investigate – does not establish *scienter*).[2]

Further, the only purported "information" to which CFSE and CCI are alleged to have had access consists of "red flags" that, as a matter of law, cannot establish *scienter*. The "red flags" alleged in the SCAC are the same ones that the court in *Stephenson v. Citco Group Limited*, No. 09 CV 00716 (RJH), 2010 WL 1244007 (S.D.N.Y. April 1, 2010), found were insufficient to establish the "strong inference of fraudulent intent" necessary to support a common law fraud claim.[3] *Id.* at *19. (*See also* SCAC ¶¶ 217, 218, 221, 222, 223.) As in *Stephenson*, certain of the purported "red flags" alleged by Plaintiffs here were not red flags at all. For example, the fact that "B[L]MIS consistently reported excellent results" and that "Madoff was both broker and custodian of the accounts" are "far too mild to support an inference of recklessness." *Id.* at *20. As to the remaining purported "red flags," the SCAC, like the complaint in *Stephenson*, "does not connect those red flags to [CFSE and CCI] through factually

[2] Plaintiffs' citation to *Cornwell v. Credit Suisse Group*, No. 08 Civ. 3758 (VM), 2010 WL 537593 (S.D.N.Y. Feb. 11, 2010), is unavailing. In that case, plaintiffs established a strong inference of recklessness by specifically referring to numerous internal reports showing that the defendants were aware that key aspects of their internal controls, risk management and exposure to the sub-prime housing market were inadequate. *Id.* at *7. Notably, this Court cautioned that "when plaintiffs contend that defendants had access to contrary facts, they must specifically identify the reports or statements containing this information." *Id.* at *6. In contrast to *Cornwell*, nowhere does the SCAC specifically identify any such reports or statements, nor are there any allegations that CFSE or CCI identified or documented particular "red flags" or expressed concerns over the veracity of account information provided by Madoff.

[3] In *Stephenson*, the plaintiff did not bring a Section 10(b) claim, and no claim of fraud was asserted against CFSE or CCI. However, the fraud claim against PricewaterhouseCoopers LLP (Ontario) was based on the same purported "red flags" that Plaintiffs claim support their federal securities law claims in this case and which Judge Holwell found insufficient to support *scienter*.

sufficient allegations that [they] actually knew of or uncovered them." *Id*. Instead, all of the allegations in the SCAC purporting to link CFSE and CCI to the purported "red flags" are wholly conclusory.[4] (*See* SCAC ¶¶ 338, 523, 524.)

Additionally, to determine whether a plaintiff's purported inferences of *scienter* are sufficiently "strong," the court must consider both the inferences urged by the plaintiff and any competing inferences rationally drawn from all the facts alleged, taken collectively. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.,* 551 U.S. 308, 310 (2007). Courts addressing the precise inference proposed by Plaintiffs in this case (*i.e*., that the service providers to funds that had accounts with BLMIS acted with an intent to defraud investors) have concluded that the more compelling inference as to why the Madoff fraud went undetected was Madoff's proficiency in covering up his scheme and deceiving the SEC, investors, and service providers alike. *Meridian Horizon Fund, LP*, 2010 WL 1257567, at *6 (observing that the service providers of the Tremont "feeder funds" were "similarly in the dark").

B. Plaintiffs Fail to Plead Actual Reliance with Respect to Their Initial Investments

With respect to each of their initial investments in the Fairfield Funds, Plaintiffs cannot establish actual reliance on any NAV statements issued by CFSE or CCI. As set forth in their Opening Memorandum, there are no circumstances under which CFSE or CCI would have sent a NAV statement to a prospective investor prior to that investor's initial investment. (Opening Memorandum at 11-12.) Plaintiffs in their Opposition make no attempt to contradict that fact.

[4] In addition, as in *Meridian Horizon Fund, LP*, CFSE and CCI, as administrators of the Fairfield Funds, did not provide any services to Madoff or BLMIS. To the contrary, at no time did CFSE or CCI assume any duty to confirm the existence of the underlying securities at BLMIS. Rather, CFSE and CCI are among the "other financial professionals" who Madoff deceived. *Meridian Horizon Fund, LP*, 2010 WL 1257567, at *12.

Thus, the Section 10(b) claims relating to their initial investments should be dismissed. *See Pension Comm. of the Univ. of Montreal Pension Plan v. Banc of Am. Sec., LLC,* 592 F. Supp. 2d 608, 629 (S.D.N.Y. 2009) (dismissing investors' reliance-based claims against hedge fund administrator with respect to investments for which plaintiffs failed to show they received NAV statements before making such investments).

Recognizing this fundamental deficiency, Plaintiffs argue that the reliance requirement is met because certain pre-2005 PPMs contained historical NAV tables (which do not identify CFSE or CCI as the source of the information), and because the number of shares they received was derived from the calculation of the Funds' NAV statements.[5] (Pl. Opp. at 44; SCAC ¶¶ 187, 335.) Yet, such allegations are no substitute for reliance on actual statements of, and attributed to, the Defendants, which the case law requires. *See Wright v. Ernst & Young LLP*, 152 F.3d 169, 173-75 (2d Cir. 1998) (rejecting theory that Ernst & Young could be held liable under Section 10(b) for statements communicated by others to investors and not attributed to Ernst & Young); *see also Pac. Inv. Mgmt. Co. LLC v. Mayer Brown LLP*, No. 09-1619-CV, 2010 WL 1659230, at *11 (2d Cir. Apr. 27, 2010) (same).[6]

II. Plaintiffs' State Law Claims Against CFSE and CCI Are Barred By SLUSA

Plaintiffs challenge only one of SLUSA's requirements. They argue that their state law claims fall outside SLUSA's broad preemptive scope because the alleged misrepresentations were made in connection with the purchase of shares in the Fairfield Funds, which are not

[5] Nowhere in the SCAC do Plaintiffs allege that the PPMs were sent out by CFSE or CCI. Furthermore, Plaintiffs do not cite to any PPM after 2004, for the simple reason that no such PPM contained those historic NAV tables. *See* D.E. 363, Exs. 1-4; D.E. 352, Ex. N.

[6] Plaintiffs' Section 10(b) claims based on investments purchased before April 24, 2004 should be dismissed for the additional reason that they are time-barred by operation of Sarbanes-Oxley's five-year statute of repose. *See* CGL Opening Memorandum at 22; CGL's Reply Brief at 9.

"covered securities." (Pl. Opp. (FGG) at 84-93.) Plaintiffs' arguments are inconsistent with the plain language of SLUSA, the applicable case law, and their own allegations.[7]

Another court in this Circuit has recently rejected the very argument that Plaintiffs now advance. In *Barron v. Igolnikov*, No. 09 Civ. 4471 (TPG), 2010 WL 882890, at *3-5 (S.D.N.Y. Mar. 10, 2010), Judge Griesa held that SLUSA preempted all state law claims against the investment manager of several Madoff feeder funds. The court reasoned that although plaintiffs purchased limited partnership interests in the feeder funds – which were not covered securities – SLUSA preemption was required because "this fraudulent scheme was in connection with the trading in the nationally listed securities in which Madoff claimed to be engaged." *Id.* at *5.

Other recent cases in this Circuit (decided subsequent to the Opening Memoranda filed in this case) have also held that SLUSA preempts state law claims under substantially similar allegations as exist in this case. In *Backus v. Connecticut Community Bank, N.A.*, No. 3:09-CV-1256, 2009 WL 5184360 (D. Conn. Dec. 23, 2009), the plaintiffs deposited their retirement savings in a collective account at the defendant bank so that their pooled monies could be used to purchase shares of two intermediate companies managed by Madoff. *Id*. at *1-2. These companies were supposed to use the plaintiffs' money to invest in Madoff's purported "split-strike strategy" but, in fact, no securities were purchased because they were part of Madoff's Ponzi scheme. *Id*. at *2-3. The court held that SLUSA applied despite the fact that shares of the intermediate companies were not "covered securities," because "the individual securities fraudulently represented to be bought, sold, and held" by the companies were "covered securities" and were "at the heart of th[e] case." *Id*.; *see also Levinson v. PSCC Servs., Inc.*, No. 3:09-CV-00269 (PCD), 2009 WL 5184363, at *8-12 (D. Conn. Dec. 23, 2009) (same); *accord*

[7] CFSE and CCI also incorporate the arguments and authorities relating to SLUSA preemption set forth in the Reply Memoranda of the FGG Defendants and the PwC Defendants.

Sullivan v. Holland & Knight LLP, No. 8:09-CV-531-T-17AEP, 2010 WL 1558553, at *6 (M.D. Fla. Mar. 31, 2010).[8]

Similarly, Madoff's representation that he was investing in covered securities is unquestionably at the heart of the instant case. In its opening paragraph, the SCAC states: "This suit arises out of the largest and longest running 'Ponzi scheme' in history – a fraud orchestrated by Bernard Madoff . . . ." (SCAC ¶ 1.) Just as in *Barron*, *Backus*, and *Levinson*, the SCAC also alleges that the fraudulent scheme was centered on misrepresentations that Madoff was trading in nationally listed securities. (*Id.* ¶¶ 184-185.)

SLUSA applies to each of Plaintiffs' state law claims. Plaintiffs' negligent misrepresentation and aiding and abetting fraud claims are preempted by SLUSA "because a misrepresentation or other fraudulent conduct is a necessary element of these causes of action." *Levinson*, 2009 WL 5184363, at *12. In addition, the remainder of Plaintiffs' state law claims should also be preempted because courts have consistently held that "non-fraud-based claims are preempted by SLUSA" where, as here (*see* SCAC ¶¶ 473, 487, 501, 505, 509, 558, 566), "they incorporate by reference allegations of false or misleading statements." *Id*. at *13 (collecting cases); *see also Barron*, 2010 WL 882890, at *4-5 (dismissing breach of fiduciary duty, aiding and abetting breach of fiduciary duty, gross negligence and unjust enrichment claims as preempted by SLUSA).

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[8] Despite the fact that *Barron*, *Backus*, and *Levinson* are the only decisions to address SLUSA preemption in the context of Madoff-related lawsuits, Plaintiffs suggest that the "better view" is expressed in *Pension Committee of the University of Montreal Pension Plan v. Banc of America Securities, LLC*, No. 05 Civ. 9016 (SAS), 2010 WL 546964 (S.D.N.Y. Feb. 16, 2010). (*See* Pl. Opp. (FGG) at 91 n.80; 92-93.) Yet, the *Pension Committee* court expressly distinguished the factual situation in that case from the Madoff situation, noting that the plaintiffs in *Backus* invested in an intermediate investment vehicle "for the purpose of purchasing covered securities." *Id.* at *3 n.27. The *Pension Committee* court then stated "[n]one of that is true here." *Id.* As a result, the court reasoned: "Unlike *Backus* . . . the covered securities are not 'at the heart' of this case." *Id.*

III. Plaintiffs' State Law Claims Are Otherwise Legally Deficient

Plaintiffs' state law claims against CFSE and CCI are legally deficient for a host of additional reasons as well.[9]

As a threshold matter, Plaintiffs' non-fraud tort claims against CFSE and CCI are preempted by the Martin Act. *See, e.g.*, *Stephenson*, 2010 WL 1244007, at *10-15. Plaintiffs' claims in this case meet the Martin Act's required geographic nexus with New York because, as Plaintiffs themselves acknowledge, "a substantial part of the events and actions of the Defendants giving rise to Plaintiffs' claims occurred in New York" (Pl. Opp. (FGG) at 47); and the "substantial wrongdoing at the core of the claims occurred in New York" (*Id.* at 103 n.86). *Stephenson*, 2010 WL 1244007, at *14-15; *see also* CBN/CGC Reply Brief at 8-10.

Further, Plaintiffs' claims against CFSE and CCI for breach of fiduciary duty, negligence, gross negligence, breach of (third party beneficiary) contract, and unjust enrichment are derivative. Because investors cannot recover on such claims without showing a corresponding injury to the fund in which they invested, Plaintiffs lack standing to assert such claims. *Stephenson*, 2010 WL 1244007, at *1, 7, 9; *see also* CBN/CGC Reply Brief at 5-7.

Plaintiffs' breach of third party beneficiary contract claim fails because Plaintiffs are not intended beneficiaries of the Administration Agreements. The *Stephenson* court rejected the exact argument Plaintiffs make in their Opposition, when it recognized that an investor in Greenwich Sentry was not an intended beneficiary of the administration agreement at issue. *Stephenson*, 2010 WL 1244007, at *9 n.12. Like *Stephenson*, in this case "[n]othing within the

[9] Plaintiffs assert claims against CFSE and CCI for third-party beneficiary breach of contract (Count 20), breach of fiduciary duty (Count 21), gross negligence (Count 22), negligence (Count 23), aiding and abetting breach of fiduciary duty (Count 24), aiding and abetting fraud (Count 25), negligent misrepresentation (Count 28), breach of fiduciary duty based on Pilgrim and Francoeur (Count 32), and unjust enrichment (Count 33).

four corners of [the administration agreement] expresses an intent to benefit third parties"; and "the Citco administrator contract contains an inurement clause that undermines any argument that the contracting parties intended to benefit third parties." *Id.*; *see also* CFSE/CCI Opening Memorandum at 14-15.

Next, Plaintiffs concede that their negligence-based claims can survive only if the SCAC pleads facts demonstrating that CFSE and CCI owed Plaintiffs a duty at the time they decided to invest in the Fairfield Funds. (Pl. Opp. at 5). Yet, because neither CFSE nor CCI made any misrepresentation to, or had contact with, any of them prior to their initial investment decisions, they cannot establish the existence of any duty in connection with any such investments.[10] *See Credit Alliance Corp. v. Arthur Andersen & Co.*, 483 N.E.2d 110, 119-20 (N.Y. 1985); *see also* discussion *supra* at 3-4. As a result, all the negligence-based claims relating to Plaintiffs' initial investments should be dismissed.

For the same reason, the SCAC fails to establish a fiduciary relationship between CFSE, CCI and Plaintiffs with respect to their initial investments. Moreover, after making their initial investments, Plaintiffs received NAV information from CFSE or CCI not because of a fiduciary relationship, but because they were registered shareholders of one of the Fairfield Funds. *Stephenson*, 2010 WL 1244007, *9 n.12. CFSE and CCI's provision of such information is insufficient to create a fiduciary duty. *Jordan (Bermuda) Inv. Co. v. Hunter Green Invs. LLC*, No. 00 Civ. 9214 (RWS), 2007 WL 2948115, at *23 (S.D.N.Y. Oct. 3, 2007) ("The mere sending of periodic account statements does not create a fiduciary duty.").[11] For these reasons,

[10] Plaintiffs' negligence-based claims relating to investments made before April 24, 2006 should be dismissed for the additional reason that they are time-barred. *See* CGL's Reply Brief at 9-10.

[11] Plaintiffs' failure to identify a legal duty owed to Plaintiffs that is separate from any contractual duty owed to the Fairfield Funds is fatal to Plaintiffs' tort claims (other than aiding

Plaintiffs' breach of fiduciary duty claims relating to all their investments should be dismissed.

Plaintiffs' gross negligence claim fails because, as demonstrated *supra* at pages 2-3, the SCAC does not state with particularity facts showing that CFSE and CCI's conduct evidenced "a reckless disregard for the rights of others or 'smack[ed]' of intentional wrongdoing." *Am. Tel. & Tel. Co. v. City of N.Y.*, 83 F.3d 549, 556 (2d Cir. 1996).

Plaintiffs' aiding and abetting claims also should be dismissed because they fall far short of the required "allegations of specific 'facts that give rise to a strong inference of actual knowledge regarding the underlying fraud' and breach of fiduciary duty." *Rosner v. Bank of China*, No. 06 CV 13562, 2008 WL 5416380, at *5-11 (S.D.N.Y. Dec. 18, 2008) (dismissing aiding and abetting fraud claim because allegations of red flags and defendant's long-term relationship with and knowledge of purported fraudster, were insufficient to establish defendant's actual knowledge of underlying fraud).[12]

As to their "holder" claims, Plaintiffs cannot establish loss causation. Plaintiffs' contention that they could have redeemed their shares because "there was substantially more 'money in the till' at those earlier times than in December 2008," is fundamentally misconceived. (Pl. Opp. at 37.) The Madoff Ponzi scheme was a fraudulent investment vehicle which generated the false appearance of profit by paying early investors out of the money invested by subsequent investors. *Stephenson*, 2010 WL 1244007, at *6. As a result, the money Plaintiffs claim they should have been paid was not, in fact, theirs to receive. (Pl. Opp. at 37;

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and abetting fraud), because those claims are barred by the economic loss rule. *See Iconix Brand Group, Inc. v. Bongo Apparel, Inc.*, No. 06 Civ. 8195 (DLC), 2008 WL 2695090, at *4 (S.D.N.Y. July 8, 2008) (emphasizing that "[t]his legal duty must spring from circumstances extraneous to, and not constituting elements of, the contract").

[12] In *Rosner*, this Court expressly rejected the "willful blindness" standard urged by Plaintiffs here, (Pl. Opp. at 27-28), noting that such standard "concedes a lack of actual knowledge." *Rosner*, 2008 WL 5416380, at *7.

SCAC ¶ 166.) Contrary to Plaintiffs' contention, they were not entitled to receive the benefit of monies in Madoff's Ponzi scheme at the detriment to other investors in the Funds. Thus, by the very nature of the alleged scheme, "holders" of the Fairfield Funds' shares would not have been in any better position had Madoff's fraud been discovered and disclosed earlier. *See Ryder Energy Distrib. Corp. v. Merrill Lynch Commodities, Inc.*, 684 F. Supp. 27, 29, 35 (S.D.N.Y. 1988), *aff'd*, 865 F.2d 492 (2d Cir. 1989).

In addition, the Opposition confirms the conclusory, and thus insufficient, nature of Plaintiffs' "holder" allegations. Not one of the six paragraphs to which Plaintiffs refer in their Opposition (*see* SCAC ¶¶ 159, 160, 175, 335, 340, 498) alleges when any Plaintiff purportedly would have redeemed its shares, how much of the investment would have been redeemed, or how CFSE or CCI supposedly induced any Plaintiff to refrain from redeeming its shares. *Hunt v. Enzo Biochem, Inc.*, 530 F. Supp. 2d 580, 600 (S.D.N.Y. 2008); *accord Hunt v. Enzo Biochem, Inc.*, 471 F. Supp. 2d 390, 411-12 (S.D.N.Y. 2006) (dismissing "holder" claims for failure to allege specific details as to each required element).

Finally, the SCAC alleges no facts to support a claim that any Citco-related Defendant acted as CFSE's or CCI's agent. *See* CGL's Reply Brief at 6-8. Thus, Plaintiffs' agency-based claims should be dismissed.[13]

CONCLUSION

For all these reasons, CFSE and CCI respectfully request that the Court dismiss all claims against them with prejudice.

[13] For any arguments not presented here, CFSE and CCI rely on their Opening Memorandum and the applicable Reply Memoranda of Law of the other Defendants. All grounds for dismissal are expressly preserved.

Dated: May 21, 2010

Respectfully submitted,

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