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

Plaintiffs,

-against-

FAIRFIELD GREENWICH LIMITED, et al.,

Defendants.

This Document Relates To: All Actions
--x

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

REPLY MEMORANDUM OF LAW IN SUPPORT OF DEFENDANT THE CITCO GROUP LIMITED'S MOTION TO DISMISS THE SECOND CONSOLIDATED AMENDED COMPLAINT

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INTRODUCTION

Plaintiffs' Opposition[1] only underscores what was clear from the SCAC: First, the allegations against CGL are insufficient to establish any of the elements of a Section 20(a) claim. Second, Plaintiffs' agency theory – the only conceivable basis for their state law claims – has no foundation in either law or fact. As a result, all the claims against CGL should be dismissed with prejudice.

ARGUMENT

I. The SCAC Fails to State a Section 20(a) Claim Against CGL

Nothing in their Opposition can obscure the fact that Plaintiffs have failed to plead ***any*** of the elements of control person liability: (i) an underlying violation of Section 10(b) by CFSE or CCI;[2] (ii) actual control by CGL over CFSE or CCI ***and*** over the transactions at issue; and (iii) the requisite state of mind – *i.e., scienter* – necessary to establish culpable participation.

A. The SCAC Does Not Adequately Plead the Element of Control

The SCAC fails to plead that CGL controlled CFSE and CCI and also fails to plead that CGL asserted control over the transactions at issue.

First, the SCAC's allegations concerning CGL's purported "corporate structure" and "one firm marketing strategy" are insufficient to support "control person" liability because there is not a single specific allegation as to ***how*** CGL actually exercised control over CFSE and CCI. *See In re Asia Pulp & Paper Sec. Litig.*, 293 F. Supp. 2d 391, 396 (S.D.N.Y. 2003) (unspecific

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[1] "Plaintiffs' Opposition" or "Pl. Opp." refers to Plaintiffs' Memorandum in Opposition to Motions to Dismiss by the Citco Defendants, Pilgrim and Francoeur (D.E. 420). "Opening Memorandum" refers to the Memorandum of Law in Support of Defendant The Citco Group Limited's Motion to Dismiss the Second Consolidated Amended Complaint (D.E. 345).

[2] Because the SCAC fails to state a claim against CFSE or CCI under Section 10(b) or Rule 10b-5, there is no predicate for a "control person" claim against CGL. *See* CFSE/CCI's Reply Memorandum at 1-4.

allegations of corporate affiliation and a "one firm" marketing concept deemed insufficient to establish control under Section 20(a)). Recognizing this deficiency, Plaintiffs attempt to bolster their boilerplate allegations of actual control by merely making reference to assertions of a purported "agreement." The fact that there is no such agreement is tacitly recognized by Plaintiffs' failure to set forth any allegations regarding the terms of the purported agreement, the date, the signatories, or the nature of the agreement (written or oral). (Pl. Opp. at 46, 47.)

Second, control cannot be established based on the conclusory allegation that "[t]he executive committee of Citco Group hires division directors to oversee the daily operations of its divisions, and reviews the directors' performance." (Pl. Opp. at 47.) It is well settled that the mere appointment of directors does not constitute control. *See In re Global Crossing, Ltd. Sec. Litig.,* No. 02 Civ. 910 (GEL), 2005 WL 1907005, at *13-14 (S.D.N.Y. Aug. 8, 2005) (dismissing control person claim where plaintiffs failed to allege facts demonstrating how the appointment of a director by an affiliate established control); *see also In re Alstom SA Sec. Litig.,* 406 F. Supp. 2d 433, 487-88 (S.D.N.Y. 2005) (same); *In re Flag Telecom Holdings, Ltd. Sec. Litig.*, 352 F. Supp. 2d 429, 458-59 (S.D.N.Y. 2005) (same). Without demonstrating ***how*** CGL controlled the so called "division directors," and ***how*** any such "division directors" controlled CFSE or CCI, Plaintiffs' allegations are legally insufficient.[3]

[3] Plaintiffs argue that *Global Crossing, Alstom*, and *Flag Telecom*, are distinguishable because *Global Crossing* focused on "status as a minority shareholder" and *Alstom* and *Flag Telecom* "addressed control by directors, not by affiliated entities." (Pl. Opp. at 48.) To the extent these cases are distinguishable, it is because the allegations in the SCAC are much weaker by comparison. Unlike the above cases, Plaintiffs do not and cannot allege that CGL appointed any members to the boards of either CFSE or CCI. Instead, what Plaintiffs allege and argue is that the element of control is established through the "division" structure of the Citco Group of Companies, pursuant to which there is a corporate reporting structure to a division director who is not formally a director or officer of either CFSE or CCI. If appointing directors to a subsidiary's board is insufficient to establish control, then surely this less formal reporting structure alleged in the SCAC is likewise insufficient.

Third, Plaintiffs would have this Court ignore its own decisions, which have consistently held that a plaintiff must plead concrete facts to establish that the defendant asserted "actual control over the transactions in question" for Section 20(a) liability to attach. *Alstom*, 406 F. Supp. 2d at 487; *In re Alstom SA Sec. Litig.,* 454 F. Supp. 2d 184, 209-10 (S.D.N.Y. 2006). Although Plaintiffs argue that CGL "had the power to control and did control the content and dissemination of the statements . . . ," such conclusory allegations are patently insufficient, particularly given Plaintiffs' admission that they have not alleged that CGL participated directly in the preparation and dissemination of the NAV statements. (Pl. Opp. at. 47.) In sum, the SCAC fails to plead sufficient facts to establish the actual control necessary for Section 20(a) liability to attach.[4]

B. <u>The SCAC Does Not Allege Culpable Participation</u>

Conceding that they have not pled facts giving rise to a strong inference that CGL culpably participated in a violation of Section 10(b), Plaintiffs argue that the pleading of such facts is unnecessary and that, instead, allegations of control suffice to establish culpable participation. (*See* Pl. Opp. at 48-49.) Plaintiffs are incorrect.

First, this Court has consistently held that, to sustain a Section 20(a) claim, a plaintiff must state with particularity facts giving rise to a strong inference that an alleged controlling

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[4] Plaintiffs are mistaken in their contention that pleadings filed in a totally unrelated litigation involving different corporate entities can be used to establish that CGL controlled CFSE and CCI. *Bruhl v. PricewaterhouseCoopers International*, No. 03-23044-Civ., 2008 WL 899253, at *3 (S.D. Fla. Mar. 31, 2008), and *Pension Committee of the University of Montreal Pension Plan v. Banc of America Securities, LLC*, 446 F. Supp. 2d 163 (S.D.N.Y. 2006), have nothing to do with the Madoff fraud or whether CGL controlled CFSE and CCI, neither of which were even defendants in those litigations. In addition, the *Pension Committee* decision is not persuasive authority because it applied the minority view by holding that "naked allegations of control" can suffice and that a plaintiff need not allege culpable participation to impose liability under Section 20(a). *Id*. at 190-91. The *Bruhl* case is distinguishable because Eleventh Circuit precedent does not recognize the culpable participation element, as is mandated by the Second Circuit. *See Bruhl,* 2008 WL 899253, at *2.

person culpably participated in the underlying fraud and did so with *scienter, i.e.,* at least recklessly. *See, e.g., Alstom,* 454 F. Supp. 2d at 209-10; *Alstom,* 406 F. Supp. 2d at 490-92. This Court has also specifically stated that merely pleading control "is not enough to plead culpable participation" under the PSLRA. *Alstom*, 406 F. Supp. 2d at 493.

In *Varghese v. China Shenghuo Pharmaceutical Holdings, Inc.*, 672 F. Supp. 2d 596 (S.D.N.Y. 2009), this Court once again held that, in order to state a claim under Section 20(a), "a plaintiff ***must allege*** . . . that the controlling person was a culpable participant in the fraud." *Id.* at 611 (emphasis added). Yet, Plaintiffs cite *Varghese* for the exact opposite proposition – that merely pleading control is sufficient to satisfy the element of culpable participation, including *scienter. Varghese* says nothing of the sort.

In *Varghese,* investors sued the CEO, CFO, and majority shareholder of China Shenghuo Pharmaceutical Holdings, Inc. ("CSP"), as primary violators under Section 10(b) and, alternatively, as control persons under Section 20(a), for allegedly participating in a scheme to inflate CSP's financial results. *Id.* at 606-08. After finding, on the basis of very specific factual allegations, that the defendants acted with *scienter* in violating Section 10(b), the Court turned to the issue of Section 20(a) liability and found that the pleading requirement for culpable participation was similarly satisfied. *Id.* at 611-12. Nothing in *Varghese* remotely suggests that a finding of control obviates the need to establish culpable participation, including the requirement of pleading *scienter*. Further, in stark contrast to *Varghese*, not one of the eight paragraphs of the SCAC that refer to CGL (*see* SCAC ¶¶ 156, 162, 320-321, 323, 528-530) contains facts that would give rise to a strong inference that CGL acted with *scienter* or otherwise culpably participated in a violation of Section 10(b).

Finally, Plaintiffs argue that their failure to allege culpable participation against CGL is cured through agency principles. (*Id.* at 49-50.) Again, Plaintiffs are mistaken. First, Plaintiffs

fail to cite to any support for their proposition that the requisite state of mind for Section 20(a) purposes can be imputed from one corporate entity to another.[5] Second, as demonstrated below at pages 5-8, neither CFSE nor CCI acted as CGL's agent.

For all of these reasons, the Section 20(a) claim against CGL should be dismissed with prejudice.

II. The State Law Claims Against CGL Should Be Dismissed Because the SCAC Does Not Establish Actual Agency

The state law claims against CGL fare no better than Plaintiffs' federal claims. In its Opening Memorandum, CGL noted that the SCAC fails to allege primary liability against CGL. Plaintiffs now concede that point by failing to even argue primary liability on CGL's part.[6] Further, having also abandoned their veil piercing theory of liability referenced in paragraph 156 of the SCAC, Plaintiffs now advance only an actual agency theory against CGL. (Pl. Opp. at 50-

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[5] Plaintiffs cite four cases which they claim support the proposition that culpable participation can be imputed to CGL through the acts of its affiliates. However, in each of those cases, the requisite state of mind was established by the alleged acts of the defendant's employee pursuant to *respondeat superior*. (Pl. Opp. at 49-50) (citing *Suez Equity Investors, L.P. v. Toronto-Dominion Bank*, 250 F.3d 87, 101 (2d Cir. 2001) (holding bank culpably participated through the acts or omissions of DeRoziere); *CompuDyne Corp. v. Shane*, 453 F. Supp. 2d 807, 831 (S.D.N.Y. 2006) (holding FNY Securities and FNY Capital culpably participated through the acts or omissions of Shane); *Cromer Fin. Ltd. v. Berger*, 245 F. Supp. 2d 552, 563 (S.D.N.Y. 2003) (holding Deloitte culpably participated through the acts or omissions of Jack); *In re Blech Sec. Litig.*, 928 F. Supp. 1279, 1300 (S.D.N.Y. 1996) (holding Baird Patrick culpably participated through the acts or omissions of Prodani)). The allegations of the SCAC fail to make any similar claim that any employee of CGL acted with *scienter*.

[6] Plaintiffs contend that they are permitted to lump together all Citco-related entities under an agency theory of liability. However, there is no agency exception to the requirements of Federal Rule of Civil Procedure 8(a). Plaintiffs' reliance on *National Group for Communications & Computers Ltd. v. Lucent Technologies, Inc.*, 420 F. Supp. 2d 253, 255-56 (S.D.N.Y. 2006), is misplaced because that case involved the narrow question of whether the plaintiffs met the statutory definition of the defined term "enterprise" under the Racketeer Influenced and Corrupt Organizations Act. The court never considered whether it is appropriate to lump multiple parties together under Rule 8(a). Clearly it is not.

53.)[7] Yet, this theory fails because the SCAC does not allege any of the elements of actual agency: (1) an agreement (*i.e*., a manifestation by CGL that the purported agents would act for CGL and the purported agents' acceptance of the particular undertaking); and (2) control (*i.e*., CGL's control of the particular undertaking). *Fletcher v. Atex, Inc.*, 68 F.3d 1451, 1461-62 (2d Cir. 1995); *see also Spagnola v. Chubb Corp.*, 264 F.R.D. 76, 89 (S.D.N.Y. 2010)("*Chubb*").[8]

A. The SCAC Fails to Allege an Express Agreement Between CGL and Either CFSE, CCI, CBN, CGC, or CSFB

Plaintiffs contend that they have properly alleged an actual agency theory of liability based on (i) marketing materials; (ii) organization as an "integrated corporate group" and use of the internet domain 'Citco.com;'" (iii) contracts with the Fairfield Funds; and (iv) appointment of "directors." (Pl. Opp. at 51-52.) These allegations, however, fail to establish the manifestation of consent and acceptance required for a finding of agency liability.

In this regard, the recent case of *Spagnola v. Chubb Corp*. is instructive. In that case, the plaintiffs sued The Chubb Corporation and its wholly owned subsidiary, Great Northern

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[7] There is no reason to reach the issue of agency liability with respect to Plaintiffs' state law claims because, as a series of decisions in Madoff-related lawsuits have confirmed, those claims should be dismissed on a variety of grounds, including Martin Act preemption, lack of standing, and SLUSA preemption. *See Stephenson v. Citco Group Limited,* No. 09 CV 00716 (RJH), 2010 WL 1244007, at *9, 10-15 (S.D.N.Y. April 1, 2010); *Meridian Horizon Fund, LP v. Tremont Group Holdings, Inc.,* No. 09 Civ. 3708 (TPG), 2010 WL 1257567, at *7-9 (S.D.N.Y. Mar. 31, 2010); *In re Tremont Sec. Law, State Law and Ins. Litig.*, No. 09 MD 2052, 08 Civ. 11117 (TPG), 2010 WL 1257580, at *6-8 (S.D.N.Y. Mar. 30, 2010); *Barron v. Igolnikov*, No. 09 Civ. 4471 (TPG), 2010 WL 882890, at *3-6 (S.D.N.Y. Mar. 10, 2010). Pursuant to Rule 10(c) of the Federal Rules of Civil Procedure, CGL adopts and incorporates by reference all grounds for dismissal set forth by CFSE, CCI, CGC, CBN and CFSB in their Opening and Reply Memoranda.

[8] Recognizing this obvious failure, Plaintiffs fall back on the argument that the question of agency is inherently factual and thus inappropriate for resolution on a motion to dismiss. (Pl. Opp. at 51.) In fact, "courts routinely dismiss claims based on an agency theory where the pleadings contain insufficient allegations in that regard." *Chubb*, 264 F.R.D. at 88; *see also Maung Ng We v. Merrill Lynch & Co., Inc.*, No. 99 Civ. 9687 (CSH), 2000 WL 1159835, at *9-11 (S.D.N.Y. Aug. 15, 2000) (dismissing agency-based claims against parent corporation with prejudice).

Insurance Company, contending that Chubb was liable for the actions of Great Northern based upon, among other things, an actual agency relationship. 265 F.R.D. at 89. The court dismissed the claim of actual agency despite significantly more extensive allegations than those in the SCAC. *Id.* at 89-90. In particular, the plaintiffs in *Chubb* alleged, among other things: (i) "Chubb and its subsidiaries [including Great Northern] were 'considered as a whole' for all material purposes"; (ii) advertisements and standard form policies only refer to "Chubb" or the "Chubb Group" with no specific reference to Great Northern; and (iii) there was a substantial overlap of senior management, officers and directors of "Chubb" and the members of the "Chubb Group." *Id.* at 82, 87, 90. Despite the above allegations, the court reasoned that "[p]laintiffs have pled no facts to indicate that Chubb . . . ever manifested to Great Northern its intent that Great Northern would be authorized to bind them by its transactions with insureds." *Id.* at 90. The court then explained that "[s]ince a manifestation of consent is an essential element of actual authority, the Court must reject" plaintiff's theory of actual agency. *Id.* This precise legal barrier prevents a finding of actual agency in this case.[9]

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[9] Plaintiffs' reliance on *Pension Committee of the University of Montreal Pension Plan* is misplaced. Liability under an actual agency theory was never at issue in that decision. Rather, an entirely different issue was in dispute – whether the court had *in personam* jurisdiction over CGL. No. 05 Civ. 996 (SAS), 2006 WL 708470, at *5-6 (S.D.N.Y. March 20, 2006); *see also Fidenas AG v. Honeywell Inc.*, 501 F. Supp. 1029, 1038 n.15 (S.D.N.Y. 1980) (holding the same strict standards for imposing liability on a parent corporation for the actions of its subsidiary are not present in determining whether a parent may be served process for acquiring personal jurisdiction); *Frummer v. Hilton Hotels Int'l, Inc.*, 19 N.Y.2d 533, 536-38 (N.Y. 1967) (recognizing that the test for determining sufficient connections to confer personal jurisdiction is a less rigorous standard than imposing liability on a parent company for the acts of a wholly owned subsidiary). Nor can Plaintiffs rely on *Cromer Finance Ltd. v. Berger,* Nos. 00 Civ. 2284 (DLC) and 00 Civ. 2498 (DLC), 2002 WL 826847, at *4 (S.D.N.Y. May 2, 2002), where, unlike the instant case, the complaint contained specific allegations of an agreement between the principal and an individual agent to convey actual authority. *See In re WorldCom, Inc. Sec. Litig.*, No. 02 Civ. 3288 (DLC), 2003 WL 21488087, at *10 (S.D.N.Y. Jun. 25, 2003) ("the [*Cromer*] complaint included specific allegations of a conveyance of actual authority").

Nor, contrary to Plaintiffs' contention, do "the contracts with the Funds" reflect a manifestation of an agency relationship among the Citco Defendants. (Pl. Opp. at 51.) Plaintiffs cannot point to any language that even suggests that the actual signatories to the relevant agreements – CFSE or CCI with respect to the Administration Agreements and CBN and CGC with respect to the Custodian Agreements – undertook to provide services for the Fairfield Funds as agents of CGL, or that CGL (a nonsignatory) somehow acknowledged an agency relationship through those agreements. *Int'l Customs Assocs., Inc. v. Ford Motor Co.*, 893 F. Supp. 1251, 1256-57 (S.D.N.Y. 1995) (holding that a subsidiary, as signatory, was not an agent of its parent absent clear contractual language indicating that the contract was entered into on behalf of the parent).

B. <u>The SCAC Fails to Allege Control of the Transactions at Issue</u>

Plaintiffs concede that an essential element of actual agency is the principal's direction and control over the transactions that constitute the alleged primary violations. (Pl. Opp. at 50.) As numerous courts have recognized: "The essence of control in an agency sense is in the ***necessity*** of the consent of the principal on a given matter. Otherwise, if the subsidiary has discretion to act, the parent cannot justifiably be said to have the essential right of control over its subsidiary's actions." *Maung Ng We,* 2000 WL 1159835, at *7 (emphasis in original). Here, there are no allegations that CFSE, CCI, CBN or CGC lacked the discretion to enter into the relevant contracts with the Funds or to provide the services called for under those contracts. The absence of such allegations is fatal to Plaintiffs' theory of actual agency, requiring dismissal of all the common law claims asserted against CGL.[10]

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[10] In its Opening Memorandum, CGL noted that the single generic allegation that "Francoeur and Pilgrim were acting as agents of Citco Group and the other Citco defendants" was insufficient to impose agency liability as regards to CGL (or any other Defendant). Plaintiffs failed to address this issue in their Opposition, thereby abandoning any attempt to establish an

III. <u>Many of Plaintiffs' Claims Are Time-Barred</u>

Even if the Court were to entertain Plaintiffs' claims against CGL, many of those claims are time-barred. Confronted with the clear application of the five-year statute of repose to federal securities claims relating to investments made before April 24, 2004, Plaintiffs erroneously argue that the period of repose begins to run on "the date of the last alleged misrepresentation." (Pl. Opp. at 57-59.) In *Arnold v. KPMG LLP*, 334 F. App'x 349 (2d Cir. 2009), the Second Circuit expressly rejected this argument, holding that the statute of repose under Sarbanes-Oxley "starts to run on the date the parties have committed themselves to complete the purchase or sale transaction." *Id*. at 351 (citing *Grondahl v. Merritt & Harris, Inc*, 964 F.2d 1290, 1294 (2d Cir. 1992)). Indeed, the *Arnold* court summarily dismissed – as "devoid of merit" – the plaintiff's contention that the period of repose begins to run at the time of the last alleged misrepresentation (even when made after the final purchase or sale of the securities). *Id.* As a result, Plaintiffs' Section 20(a) claims based on investments purchased before April 24, 2004 are time-barred.[11]

Similarly, Plaintiffs' negligence-based claims relating to investments made before April 24, 2006, are also time-barred. Plaintiffs, without citing any authority, argue that the statute of

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agency relationship between Francoeur, Pilgrim and "Citco." *See Burchette v. Abercrombie & Fitch Stores, Inc*., No. 08 Civ. 8786 (RMB)(THK), 2009 WL 856682, at *8-9 (S.D.N.Y. Mar. 30, 2009) (holding that a plaintiff's claim is deemed abandoned where plaintiff does not address arguments raised in defendant's motion to dismiss). Thus, Count 32 against CGL should be dismissed.

[11] Plaintiffs are mistaken when they argue that January 12, 2009 is the correct filing date for the complaint against CFSE and CCI. (Pl. Opp. at 56.) Federal Rule of Civil Procedure 15(c) does not apply to a consolidation. *See Morin v. Trupin*, 778 F. Supp. 711, 733-34 (S.D.N.Y. 1991) (rejecting contention that a consolidated action relates back to the filing date of a previously separate action under Federal Rule of Civil Procedure 15(c)). Since this case involves a consolidation, not an amendment of original pleadings, April 24, 2009 is the correct filing date because that is the date of the first complaint in this consolidated action naming CFSE and CCI as defendants.

limitations under C.P.L.R. Section 214(4) begins to run "upon each instance of the Citco Defendants' wrongful conduct." (Pl. Opp. at 60.) Once again, Plaintiffs are wrong. In *IDT Corp. v. Morgan Stanley Dean Witter & Co.,* 12 N.Y.3d 132 (2008), the New York Court of Appeals held that the statute of limitations under C.P.L.R. Section 214(4) starts "when all elements of the tort can be truthfully alleged in a complaint." *Id.* at 140. Thus, the date of accrual is the date the SCAC alleges Plaintiffs "first suffered loss" (*id.*) "***even though the injured party may be ignorant of the existence of the wrong or injury.***" *Nigerian Nat'l Petroleum Corp. v. Citibank, N.A.*, No. 98 Civ. 4960 (MBM), 1999 WL 558141, at *4 (S.D.N.Y. July 30, 1999) (emphasis in original).

Contrary to Plaintiffs' contention at page 59 of their Opposition, the statute of limitations for negligence would not be tolled, for the simple reason that none of the Defendants affiliated with CGL was a fiduciary to Plaintiffs. *See* CFSE/CCI Opening Memorandum at 18-20; CBN/CGC Opening Memorandum at 17-18; and Pilgrim/CFSB Opening Memorandum at 12. Nor do Plaintiffs plead with particularity that any of the Defendants affiliated with CGL took any acts with the requisite intent to fraudulently conceal their purported negligence. *Fezzani v. Bear, Stearns & Co*., No. 99 Civ. 0793 (RCC), 2005 WL 500377, at *8 (S.D.N.Y. March 2, 2005) (in order to toll the statute of limitations under the fraudulent concealment doctrine, a plaintiff must plead each of the elements with particularity as required by Fed. R. Civ. P. 9(b).)

Plaintiffs' negligence-based claims relating to investments made before April 24, 2006 are thus time-barred by operation of C.P.L.R. Section 214(4).

CONCLUSION

For all these reasons, CGL respectfully requests that the Court dismiss all claims against it with prejudice.

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Respectfully submitted,

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