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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)

MEMORANDUM OF LAW OF DEFENDANTS PRICEWATERHOUSECOOPERS ACCOUNTANTS N.V. AND PRICEWATERHOUSECOOPERS LLP IN SUPPORT OF MOTION FOR REARGUMENT

Defendants PricewaterhouseCoopers Accountants N.V. ("PwC Netherlands") and PricewaterhouseCoopers LLP ("PwC Canada") submit this memorandum of law in support of their motion pursuant to Local Civil Rule 6.3 for reargument of that part of the Court's Decision and Order dated August 18, 2010, 728 F. Supp. 2d 372 (S.D.N.Y. 2010) ("*Anwar II*") which denied PwC Netherlands' and PwC Canada's Motions to Dismiss the negligence claims in Plaintiffs' Second Consolidated Amended Complaint (the "Complaint").

Preliminary Statement

Contrary to the conclusion in *Anwar II*, the Appellate Division, First Department recently held, on virtually identical allegations as were made here, that an investor in a fund that invested with Madoff may not sue the fund's auditor for negligence. *See CRT Invs., Ltd. v. BDO Seidman, LLP*, No. 601052/09, 2011 WL 2225050 (1st Dep't June 9, 2011), attached hereto as Exhibit A.

In *Anwar II*, this Court dismissed all of plaintiffs' claims against PwC Netherlands and PwC Canada except for the negligence and negligent misrepresentation claims (Counts 13 and 14). Plaintiffs based their negligence claims on the allegation that audited financial statements were addressed to and received by investors in the funds. Applying *Credit Alliance Corp. v. Arthur Andersen & Co.*, 65 N.Y.2d 536 (1985), the Court found that plaintiffs' allegations were sufficient at the pleading stage to support plausible inferences that: (i) PwC Netherlands and PwC Canada were aware that the plaintiffs would use the financial reports that the firms had produced for the "particular purpose" of evaluating investments in the Fairfield Funds, (ii) the investors were "known parties" to the firms, and (iii) the fact that the audit reports were "addressed to" the Funds' shareholders was sufficient to establish "linking conduct" evincing the firms' understanding of plaintiffs' reliance. *See Anwar II*, 728 F. Supp. 2d at 457 (internal citations omitted).

In *CRT Investments*, the Appellate Division reached the contrary result on the same allegations -- that the audited funds' financial statements had been addressed to and received by investors. The First Department unanimously held that these same allegations were insufficient to sustain a claim by fund investors against the funds' auditor. *CRT Invs.*, 2011 WL 2225050, at *2. This authoritative statement of New York state law mandates the same result in this case.

Argument

I. APPLICABLE STANDARD FOR REARGUMENT.

"An intervening change in controlling law" such as this is one of the well-recognized grounds for granting reargument. *Anwar v. Fairfield Greenwich Ltd.*, No. 09 Civ 0118 (VM), 2010 WL 3834057, at *1 (S.D.N.Y. Sept. 13, 2010) (citing *Virgin Atl. Airways, Ltd. v. Nat'l Mediation Bd.*, 956 F.2d 1245, 1255 (2d Cir. 1992)); *see also Anwar v. Fairfield Greenwich Ltd.*, 745 F. Supp. 2d 379, 383-84 (S.D.N.Y. 2010) (granting motion for reconsideration to prevent manifest injustice).

II. RECENT NEW YORK CASE LAW ESTABLISHES THAT THE COMPLAINT FAILS TO STATE NEGLIGENCE CLAIMS AGAINST PWC NETHERLANDS AND PWC CANADA.

Under *Credit Alliance*, "[b]efore accountants may be held liable in negligence to non-contractual parties who rely to their detriment on inaccurate financial reports, certain prerequisites must be satisfied: (1) the accountants must have been aware that the financial reports were to be used for a particular purpose or purposes; (2) in the furtherance of which a known party or parties was intended to rely; and (3) there must have been some conduct on the part of the accountants linking them to that party or parties, which evinces the accountants' understanding of that party or parties' reliance." 65 N.Y.2d at 551.

In *CRT Investments*, the plaintiffs invested in the Ascot Fund and Gabriel Capital, two funds that invested in a New York fund called Ascot Partners, which in turn invested with

Madoff. When the funds' investments were lost in the Madoff fraud, the plaintiffs sued the auditors of Ascot Partners and Gabriel Capital, BDO Seidman. The First Department affirmed dismissal of the claims against BDO Seidman for failure to state a claim. *CRT Invs.*, 2011 WL 2225050, at *2.

In support of their negligence claims, the plaintiffs in *CRT Investments* alleged that they had received and relied on the fund's audited financial statements. *Id*. In particular, the plaintiffs claimed that " . . . BDO Seidman's audit report was addressed specifically to the 'Limited Partners' of Ascot Partners and Gabriel Capital."[1] Accordingly, the First Department found that the plaintiffs' allegations of "linking conduct" were limited to claims that they "were entitled to and received a copy of the audited financial statements," and that "BDO Seidman knew that the investors would rely upon the information contained in the financial statements." *CRT Invs.*, 2011 WL 2225050, at *2. The First Department held that such "minimal or nonexistent" contact does not establish the "direct nexus necessary" to impose a duty on the accountant toward the plaintiff investors. *Id.* The court emphasized that "BDO Seidman's work in the course of the audit was performed pursuant to professional standards applicable in the context of any audit, and was not undertaken pursuant to any specific duty owed to plaintiffs." *Id.*

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1. *CRT Invs., Ltd. v. Merkin*, No. 601052/2009, Amended Complaint ¶ 49, filed June 2, 2009, *available at* https://iapps.courts.state.ny.us/nyscef/ViewDocument?docIndex=IgUmTpvBOVJyDWrN44mR6g==. *See also CRT Invs., Ltd. v. Merkin*, No. 601052/09, 2010 WL 4340433, at *3 (N.Y. Sup. Ct. May 5, 2010) (referring to allegations that the audited financial statements of Ascot Fund and Gabriel Capital were "addressed to" plaintiffs). The allegations of "linking conduct" between the plaintiffs and the auditors also included the allegation that, "[o]nce CRT invested in Ascot Fund, it regularly received audited financial statements. . . . Attached to the Ascot Fund financial statements that CRT received were the Ascot Partners audited financial statements prepared by BDO Seidman. . . . BDO Seidman's audited financial statements of the Ascot funds were sent to CRT in New York." *CRT Invs.* Am. Compl. ¶ 47.

In *Anwar II*, this Court held that "actual face to face or similar direct contact" between plaintiffs and the auditors was not required, and therefore, the fact that the Fairfield funds' audit reports were addressed to the plaintiffs "was sufficient to show linking conduct evincing the PwC Member [Firms'] understanding of investors' reliance." *Anwar II*, 728 F. Supp. 2d at 456. The intervening decision of *CRT Investments* demonstrates, however, that such "minimal or nonexistent" contact is not sufficient to satisfy the "linking conduct" prong of *Credit Alliance*. *CRT Invs.*, 2011 WL 2225050, at *2 (citing *Sec. Pac. Bus. Credit v. Peat Marwick Main & Co.*, 79 N.Y.2d 695, 706 (1992)).

Rulings "from [state intermediate appellate courts] are a basis for 'ascertaining state law which is not to be disregarded by a federal court unless it is convinced by other persuasive data that the highest court of the state would decide otherwise.'" *DiBella v. Hopkins*, 403 F.3d 102, 112 (2d Cir. 2005) (quoting *West v. AT&T*, 311 U.S. 223, 237 (1940)). The *Credit Alliance* analysis employed by the First Department in *CRT Investments* is a sound indicator of how the New York Court of Appeals would rule on this same issue.

Indeed, a recent decision by the Court of Appeals applying the *Credit Alliance* analysis to negligence claims against a professional engineer is consistent with the First Department's analysis in *CRT Investments*. In *Sykes v. RFD Third Avenue 1 Associates, LLC*, the New York Court of Appeals focused on the "known party" prong of *Credit Alliance* in affirming dismissal of a negligent misrepresentation claim against building engineers. 15 N.Y.3d 370, 373-74 (2010).

In *Sykes*, plaintiff apartment owners, who had received and relied on offering plans prior to purchasing their apartments, claimed that the defendant mechanical engineers, Cosentini Associates, made negligent misrepresentations in the offering plans about the heating and air

conditioning systems. *Sykes*, 15 N.Y.3d at 372. The Court of Appeals held that plaintiffs failed to sufficiently allege that they were "known parties", about whose reliance the defendant engineers should have known. *Id.* at 373-74. The Court of Appeals explained:

> While Cosentini obviously knew in general that prospective purchasers of apartments would rely on the offering plan, there is no indication that it knew these plaintiffs would be among them, or indeed that Cosentini knew or had the means of knowing of plaintiffs' existence when it made the statements for which it is being sued.

Id. The Court of Appeals emphasized that "[t]he words 'known party or parties' in the *Credit Alliance* test mean what they say." *Id*. To make this point, the court explained its decision in *Westpac Banking Corp. v. Deschamps*, 66 N.Y.2d 16 (1985), which the Court issued shortly after its decision in *Credit Alliance*. *Id.* at 373-74. Westpac had made a bridge loan to Turnkey and then sued Turnkey's auditors when Turnkey failed to repay the loan. *Id*. "Westpac alleged that, when [Turnkey's auditor] Seidman made the certification [of Turnkey's financial statements], it knew that a bridge lender would rely on it, and that it knew or could have known that Westpac was a possible bridge lender." *Id.* The Court of Appeals held that this was not enough:

> Westpac claims only that it was one of a class of 'potential bridge lenders,' to which class as a whole Seidman owed a duty, and that it should be considered a 'known party' because it was as of the date of the certification a substantial lender to Turnkey, and 'thus a prime candidate for a bridge loan.' This is not, however, the equivalent of knowledge of the identity of the specific nonprivy party who would be relying on the audit reports' (*Credit Alliance Corp. v. Anderson & Co.*, 65 NY2d, at p 554…).

Sykes, 15 N.Y.3d at 373-74 (quoting *Westpac*, 66 N.Y.2d at 19). The court observed that *Westpac* "was, if anything, a stronger case for the plaintiff" than *Sykes* because the *Westpac* plaintiff was already a lender to the auditor's client at the time of the audit. *Id.* at 374. In *Sykes*, on the other hand, it was "not even alleged that Cosentini knew or had the means of knowing that plaintiffs were possible purchasers of an apartment." *Id*. The Court of Appeals concluded that because the engineers in *Sykes* "did not know 'the identity of the specific nonprivy party who

would be relying,' the complaint falls short of satisfying the *Credit Alliance* test." *Id.* (internal citation omitted).

The *Sykes* and *Westpac* decisions illustrate that the First Department's decision in *CRT Investments* is consistent with the Court of Appeals' application of the "known party" prong, and as such, the decision in *CRT Investments* is a reliable indicator of how the Court of Appeals would decide the issue. *See Michalski v. Home Depot, Inc.*, 225 F.3d 113, 116 (2d Cir. 2000) ("In determining how the Court of Appeals would rule on [a] question, the decisions of New York State's Appellate Division are helpful indicators."). *CRT Investments* demonstrates that, in order to establish a duty on the part of accountants to investors, a negligence claim must allege conduct more substantial than the mere fact that financial statements were sent or even addressed to investors. *CRT Invs.*, 2011 WL 2225050, at *2. Plaintiffs' negligence claims here failed to do so, and, accordingly, should be dismissed.

Conclusion

For the foregoing reasons, defendants PwC Netherlands and PwC Canada respectfully request that this Court allow reargument of those portions of PwC Netherlands' and PwC Canada's Motions To Dismiss directed to plaintiffs' negligence claims (Counts 13 and 14), and dismiss those claims against PwC Netherlands and PwC Canada.

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Respectfully submitted,

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