UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

PASHA S. ANWAR, *et al.*,

Plaintiffs,

v.

FAIRFIELD GREENWICH LIMITED, *et al.*,

Defendants.

This Document Relates To: All Actions

Master File No. 09-cv-118 (VM)

PLAINTIFFS' MEMORANDUM IN OPPOSITION TO MOTIONS TO DISMISS BY THE CITCO DEFENDANTS, PILGRIM AND FRANCOEUR

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Plaintiffs hereby file their consolidated response in opposition to the motions to dismiss filed by Defendants Citco Fund Services (Europe) B.V. and Citco (Canada) Inc. (Dkt. 329), Citco Bank Nederland N.V. Dublin Branch and Citco Global Custody N.V. (Dkt. 340), Citco Group Limited (Dkt. 344), Citco Fund Services (Bermuda) Limited and Ian Pilgrim (Dkt. 334), and Brian Francoeur (Dkt. 318).

PRELIMINARY STATEMENT

The Citco Defendants sued in Plaintiffs' Second Consolidated Amended Complaint (the "SCAC") were intimately involved in the operations of Fairfield Greenwich Group's four Madoff feeder Funds (the "Funds" or "FGG Funds"). They assumed responsibilities far greater than those of the typical fund administrator or custodian, served as directors of the Funds' investment manager/general partner, and were directly responsible for the losses suffered by Plaintiffs in the Madoff Ponzi scheme because of their total failure to fulfill their duties to Plaintiffs. Yet in their motions to dismiss they seek to avoid responsibility for investors' billions in losses.

The fund administrators, Citco Fund Services (Europe) B.V ("Citco Fund Services") and Citco (Canada) Inc. ("Citco Canada") (collectively, the "Citco Administrators"), and the fund custodian and depositary, Citco Bank Nederland N.V., Dublin Branch ("Citco Bank") and Citco Global Custody N.V. ("Citco Global") (collectively, the "Citco Custodians"), as supposedly independent fund service providers and fiduciaries to Plaintiffs, were uniquely situated to protect Plaintiffs from Madoff's theft, yet instead, they utterly failed to fulfill their duties to Plaintiffs. The Citco Administrators were responsible for *independently* calculating the Funds' net asset value, ("NAV"), and *independently* reconciling trading and portfolio information provided by the Funds' manager and broker, Madoff. Nevertheless, they communicated the NAV and other

information to Plaintiffs, in reckless disregard of whether the NAV calculation was supported by reliable information or indeed, any assets at all, and knowing that the information they were providing was contradicted by numerous red flags surrounding Madoff's operations and results. Each of the Plaintiffs invested on the basis of the false and misleading NAV. The Fund custodians and depositary, Citco Bank Nederland N.V., Dublin Branch ("Citco Bank") and Citco Global Custody N.V. ("Citco Global") (collectively, the "Citco Custodians") committed to safeguard Plaintiffs' assets – including through monitoring Madoff – yet they utterly failed to fulfill this duty, also ignoring obvious red flags while blindly entrusting Plaintiffs' assets to Madoff.

Another Citco entity, Citco Fund Services (Bermuda) Limited ("Citco Bermuda"), also became involved with the Funds and the FGG Defendants to solidify the lucrative position of the other Citco Defendants as service providers to the Funds.[1] Citco Bermuda was paid by the FGG Defendants to have two of its employees, Defendants Ian Pilgrim and Brian Francoeur (the "Citco Directors") serve as members of the Board of Directors of Fairfield Greenwich (Bermuda) Limited ("FGBL"), which acted as the investment manager/general partner of the FGG Funds. The Citco Directors were also fiduciaries to Plaintiffs, yet rather than alerting Plaintiffs to the misrepresentations of the FGG Defendants, including FGBL, and the extreme shortcomings in the monitoring of Madoff, they facilitated the misconduct. Under basic principles of agency law and *respondent superior*, Citco Bermuda is liable for the breaches of fiduciary duty and other torts committed by its employees in the course of their employment, which included their actions as FGBL directors.

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[1] As used herein, "Citco Defendants" refers to Citco Group, the Citco Administrators, the Citco Custodians, Citco Bermuda, Pilgrim and Francoeur.

The Citco Defendants were not independent entities that all just happened to be engaged with the FGG Funds. Rather, the Citco Defendants operated in their extensive relations with the Funds as one corporate entity – Citco – led by parent company Citco Group Limited ("Citco Group"), which advertised and promoted its independence and fiduciary services to investors. Each Citco defendant was directly controlled by Citco Group, and served as the agent of Citco Group and of each other.

Accordingly, the Citco Defendants cannot avoid liability as a matter of law, and the motions to dismiss should be denied.

ARGUMENT

I. PLAINTIFFS STATE LAW CLAIMS SHOULD NOT BE DISMISSED

A. Plaintiffs Have Stated Claims for Negligence, Gross Negligence, and Negligent Misrepresentation.

1. The Citco Administrators Owed Plaintiffs a Duty.

For purposes of the negligence, gross negligence and negligent misrepresentation claims, the Citco Administrators do not contest that Plaintiffs' allegations establish breach, but rather, contend that they owe no duty to Plaintiffs.[2]

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[2] The negligence and gross negligence claims are governed by the Rule 8 pleading standard. *See, e.g., Rombach v. Chang*, 355 F.3d 164, 178 (2d Cir. 2004) (negligence claims); *In re Methyl Tertiary Butyl Ether Prods. Liab. Litig.*, 415 F. Supp. 2d 261, 278 (S.D.N.Y. 2005) (negligence claims); *Kinsey v. Cendant Corp.*, 2005 WL 1907678, at *7 (S.D.N.Y. Aug. 10, 2005) (gross negligence claims). It is unclear in the Second Circuit whether the Rule 8(a) pleading standard also applies to plaintiffs' negligent misrepresentation claim. *See, e.g., Eternity Global Master Fund Ltd. v. Morgan Guar. Trust Co.*, 375 F.3d 168, 188 (2d Cir. 2004) ("Rule 9(b) may or may not apply to a state law claim for negligent misrepresentation."); *compare Liberty Media Corp. v. Vivendi Universal, S.A.*, 2004 WL 876050, at *2 (S.D.N.Y. Apr. 21, 2004) (applying Rule 8 to negligent misrepresentation claim), and *In re Parmalat Sec. Litig.*, 479 F. Supp. 2d 332, 340 n.30 (S.D.N.Y. 2007) (applying Rule 9(b) to negligent misrepresentation claim because it incorporated the fraud claims and thus, alleged intentional, not negligent, misrepresentation). Plaintiffs contend that the Rule 8(a) standard should apply because its negligent misrepresentation claim is separate from its fraud claims, but Plaintiffs have, in any event, also satisfied the Rule 9 pleading standard, as set forth herein.

The Citco Administrators' basis for arguing that they owe no duty of care for purposes of the negligence claims is that Plaintiffs are not third party beneficiaries under the contracts. (Adm. Br. at 17-18.) This argument – which is devoid of any case support – proves too much. Under Defendants' view, a plaintiff could never bring a tort claim unless a contractual duty existed, but then the tort claim would be barred by the economic loss rule, so in fact, no tort claims at all could exist. This is not the law.

In *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), the court found that Citco Fund Services (Curacao) N.V. owed a duty of care to investors in funds for which it was administrator. *Id.* at 172-73, 199-200. The duty arose from Citco's having undertaken discretionary responsibilities, such as to "conduct a fair and independent valuation of the Funds." *Id.* at 173. *See also Harmelin v. Man Fin. Inc.*, 2007 WL 2739579 (E.D. Pa. Sept. 20, 2007) (upholding negligence claim against fund administrator that had failed to properly calculate the NAV by failing to independently verify assets and to ensure that it had access to all of the fund's trading accounts).

The Citco Administrators here undertook similar discretionary responsibilities, including to independently calculate the Funds' NAV, to independently reconcile portfolio holdings, to reconcile balances at the Funds' broker (Madoff), to reconcile information provided by the Funds' prime broker (Madoff) with the information provided by the Investment Manager, to prepare accurate financial statements, and to relay accurate information to investors. (SCAC ¶¶ 157-58, 327-35.) These significant discretionary responsibilities establish a duty of care to Fund investors.[3]

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[3] *Eurycleia Partners, LP v. Seward & Kissel, LLP*, 849 N.Y.S.2d 510, 512 (App. Div. 1st Dep't 2007) (cited in Adm. Br. at 17) is inapposite. There, the court found only that a law firm which had prepared the fund's offering memorandum and provided legal advice "solely related to the fund's formation and to

The Citco Administrators further contend (at 20-22) that they had no duty to provide correct information to Plaintiffs, for purposes of the negligent misrepresentation claim, because they were not in a relationship of privity or near-privity with Plaintiffs.[4] A duty to provide correct information arises where the parties' relationship approaches privity. *See VTech Holdings, Ltd. v. PricewaterhouseCoopers, LLP*, 348 F. Supp. 2d 255, 262-64 (S.D.N.Y. 2004). Such a relationship is established under the *Credit Alliance* test by allegations of: "(1) an awareness by the maker of the statement that it is to be used for a particular purpose; (2) reliance by a known party on the statement in furtherance of that purpose; and (3) some conduct by the maker of the statement linking it to the relying party and evincing its understanding of that reliance." *Pension Comm.*, 446 F. Supp. 2d at 199 (*quoting Prudential Ins. Co. v. Dewey, Ballantine, Bushby, Palmer & Wood*, 590 N.Y.S.2d 831, 834-35 (N.Y. 1992)). Plaintiffs satisfy each of these elements.

On the first element, the Citco Administrators argue (at 21) that Citco "would not have expected prospective investors to receive, much less rely on, the funds' NAVs in making their investment decisions." To the contrary, Plaintiffs' allegations here establish Citco's knowledge that the information they provided would be used by Plaintiffs for the particular purpose of making investment decisions. (SCAC ¶¶ 333, 502, 506, 535.) (*See also* discussion below at 6-

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tax law" – the propriety of which was not challenged – owed no duty to fund investors. *Id.* In contrast, the SCAC establishes that Citco had significant discretionary responsibilities in the ongoing operation of the funds, that they were aware that their NAV calculations would be disseminated to investors for use in making their investment decisions, and that they communicated directly to investors. (SCAC ¶¶ 157-58, 327-35.) In addition, Plaintiffs are challenging the propriety of Citco's representations.

[4] Notably, the Citco Administrators' arguments on the negligent misrepresentation claim only address *prospective* fund investors. However, Plaintiffs' negligent misrepresentation claim encompasses misrepresentations to Plaintiffs who were already investors in the funds, and relied on Defendants' communications in retaining their investments and/or in making subsequent investments. (SCAC ¶ 534.) Accordingly, Citco rightly concedes that a sufficient near-privity relationship exists for such claims. *See, e.g., Pension Comm.*, 446 F. Supp. 2d 163, 199-200; *Pension Comm. of the Univ. of Montreal Pension Plan v. Banc of Am. Sec., LLC*, 592 F. Supp. 2d 608, 641 (S.D.N.Y. 2009).

8.) The Citco Administrators were retained for the specific purpose of independently calculating the Funds' NAVs and independently reconciling the balances and portfolio holdings with Madoff. (*Id.* ¶¶ 327, 334.) Plaintiffs, as prospective investors, sent their initial subscription documents and investment assets directly to the Citco Administrators, who sent back investment confirmations. (*Id.* ¶ 157, 328.) The number of shares that Plaintiffs received in exchange for their investment dollars depended directly on Citco's NAV calculations, as did the profits reported to Plaintiffs who retained their investments. (*Id.* ¶ 335.) Thus, the Citco Administrators "knew that Plaintiffs would rely upon the false NAV and account balance statement for the particular purpose of deciding whether to invest," and that the NAV "was fundamental to Plaintiffs' initial investment decisions." (*Id.* ¶¶ 335, 535.) Furthermore, Citco's marketing materials recognize the importance of the role played by the fund administrator to investors, and provided them with assurance about the quality of Citco's services. (*Id.* ¶¶ 324-26.) Indeed, Citco touted on its website that "[b]y providing fully independent services, we act as a reliable fiduciary to safeguard the interests of investors." (*Id.* ¶ 325.)

In *Pension Committee*, the court upheld the negligent misrepresentation claim because plaintiffs similarly alleged that "the NAV was the only measure by which they could evaluate shares in the Funds in order to make investment decisions," and because Citco's marketing materials said that Citco would "serve the interests of investors by providing them with the independent, accurate and timely information they need to make informed decisions about their investments." *Pension Comm.*, 446 F. Supp. 2d at 199-200. In a later *Pension Committee* decision partially denying Citco's summary judgment motion, the court found that plaintiffs had presented evidence that Citco was aware its NAV calculations would be used for "a particular purpose," and found that it would be "disingenuous" for Citco to argue that it was not aware that

investors would rely on the NAV to evaluate investment performance. 592 F. Supp. 2d 608, 641 (S.D.N.Y. 2009). Given the allegations here, Citco's arguments are equally "disingenuous." (SCAC ¶¶ 333, 502, 506, 535.) Therefore, the first prong of the *Credit Alliance* test is satisfied.[5]

The Citco Administrators argue (at 21) that the second prong of *Credit Alliance*, the "known party" element, is not satisfied because "Plaintiffs, as prospective pre-investors, can only allege that they were part of a faceless or general class of persons." This argument is wrong legally, and is belied by the facts. Plaintiffs were specifically known to the Citco Administrators because, prior to investing, Plaintiffs sent their initial subscription documents and investment assets directly to the Citco Administrators, who thereby learned Plaintiffs' identity. (SCAC ¶ 328.) Prospective investors can be "known parties" under these circumstances. *See Fraternity Fund Ltd. v. Beacon Hill Asset Mgmt. LLC*, 376 F. Supp. 2d 385, 411 (S.D.N.Y. 2005) ("first-time investors" justifiably relied on defendant fund managers and principals "to publish accurate information about the Funds they managed"); *AUSA Life Ins. Co. v. Ernst and Young*, 206 F.3d 202, 223 (2d Cir. 2000) (upholding negligent misrepresentation claim where auditors prepared no-default letters which they knew would be for the purpose of being forwarded to note holders, some of which subsequently used the letters to determine whether to make an additional loan).[6]

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[5] Defendants only cite on the "awareness" prong, *American Manufacturers Mutual Insurance Co. v. Payton Lane Nursing Home, Inc.*, 2007 WL 674691 (E.D.N.Y. Feb. 28, 2007) (Adm. Br. at 21), found an architect owed no duty to a surety to provide correct information because the purpose of the architect's involvement in the project was to design the site, not to document performance compliance with contractual requirements, such as preparing a log on which the surety sought to rely. *Id.* at **20-21. In contrast here, Citco's primary job was to calculate accurately the NAVs and reconcile the Funds' financial information.

[6] In the lone case cited by Defendants on the "known party" prong, *Security Pacific Business Credit, Inc. v. Peat Marwick Main & Co.*, 586 N.Y.S.2d 87 (N.Y. 1992) (Adm. Br. at 21), the court did not focus on the "known party" prong; rather, it found that the plaintiff (who lent money to a company on the basis of an audit) and the defendant auditor lacked a relationship sufficiently approaching privity because the audit was only "incidentally or collaterally for the use of those to whom" the company might thereafter provide the audit. *Id.* at 94. In contrast, Citco's NAV calculations were fundamentally for the purpose of

Finally, the Citco Administrators argue (at 22) that the third prong of the near-privity test is not satisfied because Plaintiffs have not alleged the required "linking conduct," and that Plaintiffs "actually relied" on the NAV or account balance statements when making initial or subsequent investments. Direct dealings between the defendant and the third party are not required to show linking. *See Dorking Genetics v. United States*, 76 F.3d 1261, 1270-71 (2d Cir. 1996). Rather, the linking prong is satisfied where a service provider is aware of a "particular purpose" for its engagement – to be used by the third party – and acts to further that purpose. *Ossining Union Free Sch. Dist. v. Anderson*, 541 N.Y.S.2d 335, 339-40 (N.Y. 1989) ("linking conduct" is "some conduct by the defendants linking them to the party or parties and evincing defendant's understanding of their reliance."); *Pension Comm.*, 592 F. Supp. 2d at 641 ("Citco NV's monthly mailing of NAV statements and other correspondence with plaintiffs is sufficient to establish a "linking" to plaintiffs such that it would have understood plaintiffs' reliance on these statements."); *Pension Comm. of the Univ. of Montreal Pension Plan v. Banc of Am. Sec., LLC*, 617 F. Supp. 2d 216, 221 (S.D.N.Y. 2009) (transmission of NAV statements to "interested parties" sufficient to satisfy linking requirement). Thus, where a service provider has reason to believe that information prepared by it would be disseminated by others to prospective investors, the linking requirement is satisfied. *See Gutman v. Equidyne Extractive Indus. 1980 Petro/Coal Program I*, 1990 WL 113193, at *5 (S.D.N.Y. July 25, 1990) (finding linking requirement satisfied because "it was foreseeable, and in fact intended, that [the plaintiff] . . ., and all prospective investors, would review the Offering Memorandum and tax opinion letter and, as intended third-party viewers of the documents, rely on them for investment purposes.")

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ascertaining how many shares Plaintiffs' investment would purchase, and subsequently, how much Plaintiffs' shares were worth. (SCAC ¶ 335.)

Plaintiffs' allegations establish the requisite "linking conduct" under the above standards. As shown above, Citco knew of Plaintiffs' reliance because it received Plaintiffs' initial subscription documents and investment assets, sent directly to Citco, which sent back investment confirmations. (SCAC ¶¶ 157, 328.) Plaintiffs relied on the Citco Administrators' NAV calculations, and reasonably and foreseeably reposed trust and confidence in them. (*Id.* ¶ 335.) The Citco Administrators knew how important the NAVs were to Plaintiffs, and knew that potential and current investors were relying on them to make investment decisions. (*Id.* ¶ 333.) In addition, the Citco Administrators allowed their names, and the services they were ostensibly providing, to be included in the Funds' placement memoranda for prospective investors, and knew that their involvement provided potential investors with assurance about the quality of financial services provided to the Funds and the accuracy of reports and investment values. (*Id.* ¶¶ 333, 342.)

2. The Citco Custodians Owed Plaintiffs a Duty.

As to the negligence and gross negligence claims, the Citco Custodians (citing no authority) contend that they owed no duty of care to Plaintiffs. (Cust. Br. at 18.) To the contrary, such a duty of care exists because the Citco Custodians also undertook significant discretionary responsibilities. *See Pension Comm.*, 446 F. Supp. 2d at 172-73; *Fraternity Fund*, 376 F. Supp. 2d at 415. The Citco Custodians were obligated to ensure that securities purchased for the Funds were in the custody of sub-custodians, supervise Madoff as sub-custodian, maintain Fund records, engage with and transfer assets to sub-custodians, and regularly communicate with the Funds' managers. (SCAC ¶¶ 159-60.) Critically, they were responsible for taking due care in the ongoing monitoring of Madoff as sub-custodian, and they agreed to employ experts in the execution of their duties. (*Id.* ¶ 330.) Furthermore, the Citco Custodians

had the authority to "act without first obtaining instructions from the Fund[s]" if such action was necessary "to preserve or safeguard the Securities or other assets of the Fund[s]," and had absolute discretion to refuse to execute instructions by the Funds. (*Id.*) As custodians, Citco Global and Citco Bank agreed to use their best efforts and due care in the execution of their duties. (*Id.* ¶ 331.) These duties went beyond those of a typical fund custodian in that they imposed significant discretionary responsibilities. (*Id.*) Under the standards set forth above (at 4-5), these significant discretionary duties give rise to a duty of care to the Plaintiffs for purposes of the negligence and gross negligence claims.

3. Plaintiffs' Allegations of Recklessness Are Sufficient to State a Gross Negligence Claim.

The Citco Administrators argue (at 17-18) that Plaintiffs' gross negligence claim does not adequately allege the requisite culpability.[7] Gross negligence is an "extreme departure from the standards of ordinary care." *AMW Materials Testing, Inc. v. Town of Babylon*, 584 F.3d 436, 454 (2d Cir. 2009); *Colnaghi, U.S.A., Ltd. v. Jewelers Prot. Servs., Ltd.*, 595 N.Y.S.2d 381, 383 (N.Y. 1993) (gross negligence evinces "a reckless disregard for the rights of others"); *AT&T v. City of New York*, 83 F.3d 549, 556 (2d Cir. 1996) (a "gross failure to exercise due care").

Plaintiffs' allegations are sufficient to establish gross negligence. Plaintiffs allege that the Citco Administrators "grossly failed to exercise due care" (SCAC ¶ 503); that they were "grossly deficient in the fulfillment of . . . duties to Plaintiffs" (*id.* ¶ 336); that they acted in reckless disregard of their duties, failing to exercise prudence "that would be expected of any reasonable investment professional" (*id.* ¶ 503); and that they "utterly failed to make reasonable, industry-standard steps to fulfill its duties as administrator . . . ." (*Id.* ¶ 336.) The Citco

[7] Only the Citco Administrators have moved to dismiss the gross negligence claim on this ground although the gross negligence claim is against all Citco Defendants. Accordingly, the other defendants have conceded the adequacy of the claim.

Administrators "failed to take reasonable steps, industry-standard to calculate the Funds' NAV; to reconcile balances at the Funds' broker, Madoff; to independently reconcile the Funds' portfolio holdings with Madoff; to reconcile information provided by Madoff . . . with information provided by the Investment Manager; to prepare the monthly financial statements in accordance with International Accounting Standards; or to relay accurate information to investors." (*Id.* ¶ 337.) The Citco Administrators committed all of these errors recklessly, despite claiming that they had superior expertise in the financial services field. (*Id.* ¶¶ 324-25, 338.)

In particular, the Citco Administrators "blindly and recklessly relied on information provided by Madoff and the Funds to calculate and disseminate the Funds' NAV, and to perform its other duties, even though that information was manifestly erroneous" given the numerous red flags. (SCAC ¶ 338.) "Citco could not have reasonably relied on this information because the roles of investment manager, sub-custodian and trade execution agent were consolidated in Madoff, thus hugely increasing the risk of fraud, and the need for independent verification and scrutiny, as Citco was well aware." (*Id.*) Moreover, the trade and profit information from Madoff "was, on its face, virtually impossible to achieve," which should have caused Citco to inquire, scrutinize, and independently verify the information provided. (*Id.*)

The Citco Administrators also were aware of or willfully blind to the other Defendants' violations. Due to its "long-standing involvement in the Funds, and its experience in fund management," the Citco entities "knew or [were] . . . willfully blind" to the gross deficiencies in the Fairfield Defendants' due diligence and risk controls. (SCAC ¶ 341.) Citco entities thus knew that the Fairfield Defendants' representations that they were monitoring and performing

due diligence on the Fund managers were false, or at least were "willfully blind to the evident falsity." (*Id.*)

These allegations are clearly sufficient to establish recklessness. *See, e.g., Court Appointed Receiver of Lancer Offshore, Inc. v. The Citco Group Ltd.*, 2008 WL 926509, at **4, 7 (S.D. Fla. March 31, 2008) (upholding gross negligence claim where defendants had willfully and recklessly "fail[ed] to use reasonable skill and care to value the Net Asset Values . . . and independently price the Offshore Funds," and had "willingly, knowingly, consciously, and recklessly failed to use reasonable skill and care to be aware of, discover, investigate and report numerous glaring red flags"); *Cromer Fin. Ltd. v. Berger*, 2001 WL 1112548, at **2-3 (S.D.N.Y. Sept. 19, 2001) (upholding gross negligence claim where defendant "issued materially false and misleading audit reports" and "knew or recklessly disregarded" that the reports were "the principal means by which investors were induced to purchase shares..., to increase their shares . . . and/or to retain their existing shares" and "there was no other purportedly independently-verified information available to investors on which they could rely"); *Cromer Fin. Ltd. v. Berger,* 137 F. Supp. 2d 452, 464 (S.D.N.Y. 2001) (allegations of negligence and gross negligence against offshore fund administrator sustained where "[p]laintiffs allege[d] that they and other Class members relied on the fictitious reports [prepared by the administrator] and 'would not have purchased or maintained their shares in the Fund' if they had known that the monthly NAV statements were materially false and misleading'").[8]

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[8] The case law cited by Defendants on the recklessness issue is inapposite. In *AT&T v. City of New York,* 83 F.3d 549, 556 (2d Cir. 1996) (Adm. Br. at 17-18), the Second Circuit found that the district court misapplied the gross negligence standard at summary judgment (*i.e.*, after discovery), because, rather than considering the nature of the carrier's errors, and whether they constituted a gross failure to exercise due care, the plaintiff had focused on the magnitude of harm to the plaintiff. *Id.* at 551. Likewise, in *In re Enron Corp.*, 292 B.R. 752, 755 (Bankr. S.D.N.Y. 2003) (Adm. Br. at 18), also decided on summary judgment, the court held that there was no allegation that the conduct in question was "(i) reckless, (ii)

The Citco Administrators (at 18) attempt to equate the standard for gross negligence with the requirement of scienter in a securities fraud case. This is incorrect. *See, e.g., Di Maio v. State*, 517 N.Y.S.2d 675, 679 (N.Y. Ct. Cl. 1987) (*citing Marine Midland Bank v. Russo Produce Co.*, 427 N.Y.S.2d 961 (N.Y. 1980) ("Negligence, whatever its grade, does not include a wrongful purpose . . . .")); *Jordan v. Madison Leasing Co.*, 596 F. Supp. 707, 710 (S.D.N.Y. 1984) (gross negligence is "not equivalent to fraud"); *Equitable Life Assurance Soc. v. Alexander Grant & Co.*, 627 F. Supp. 1023, 1033 (S.D.N.Y. 1985) ("grossly negligent misrepresentation is clearly distinguished from fraudulent misrepresentation"). In any event, Plaintiffs have also established, *see* pp 41-43 below, that the SCAC establishes scienter for the fraud claims.

B. Plaintiffs Have Stated Claims for Breach of Fiduciary Duty.

1. <u>The Citco Administrators Owed a Fiduciary Duty to Plaintiffs.</u>

The elements of a claim for breach of fiduciary duty are "breach by a fiduciary of a duty owed to plaintiff; defendant's knowing participation in the breach; and damages." *Pension Comm.*, 446 F. Supp. 2d at 196-98. The Citco Administrators only challenge part of the first element – whether as administrators they owed Plaintiffs any fiduciary duty. (Adm. Br. at 18-20.)[9]

A fiduciary relationship arises where "one party's superior position or superior access to confidential information is so great as virtually to require the other party to repose trust and confidence in the first party," and the defendant was "under a duty to act for or to give advice for

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with knowledge that . . . [its] actions or omissions probably would result in damage or injury, or (iii) in a manner that implied a reckless disregard of the probable consequences." *Id.* at 781-82. Furthermore, the conduct was consistent with the party's obligations under an agreement. *Id.* at 782. In contrast, here the allegations are that Citco's conduct constituted a gross failure to exercise due care and comply with its obligations.

[9] Plaintiffs' fiduciary duty claims are governed by the Rule 8 pleading standard. *JP Morgan Chase Bank, N.A. v. IDW Group, LLC*, 2009 WL 321222, at *12 (S.D.N.Y. Feb. 9, 2009) (breach of fiduciary duty claims.)

the benefit of another upon matters within the scope of the relation." *Pension Comm.*, 446 F. Supp. 2d at 195-96; *Zimmer-Masiello, Inc. v. Zimmer, Inc.*, 552 N.Y.S.2d 935, 937 (App. Div. 1st Dep't 1990). Whether a fiduciary duty exists between two parties is a "fact-specific inquiry." *Pension Comm.*, 446 F. Supp. 2d at 196; *Litton Indus., Inc. v. Lehman Bros, Kuhn Loeb, Inc.*, 767 F. Supp. 1220, 1231 (S.D.N.Y. 1991); *Musalli Factory for Gold & Jewellry v. JPMorgan Chase Bank*, 261 F.R.D. 13, 26 (S.D.N.Y. 2009) ("New York courts generally avoid dismissing a claim of breach of fiduciary duty . . . because it usually involves a question of fact: whether someone reposed trust and confidence in another who thereby gains a resulting superiority or influence."); *Abercrombie v. Andrew Coll.*, 438 F. Supp. 2d 243, 274 (S.D.N.Y. 2006) (whether a fiduciary duty exists "normally depends on the facts of a particular relationship, [and] therefore a claim alleging the existence of a fiduciary duty is not subject to dismissal"). The existence of a fiduciary relationship cannot be determined "by recourse to rigid formulas." *Litton*, 767 F. Supp. at 1231.

In this case, the Citco Administrators had such superior access to confidential information that Plaintiffs were compelled to repose their trust and confidence in Citco when investing in the Funds. Indeed, Citco acknowledged on its website that "[b]y providing fully independent services, we act as a reliable fiduciary to safeguard the interests of investors." (SCAC ¶ 325.) Before investing, Plaintiffs were provided with private placement memoranda, at least some of which contained historical values of the Funds that had been calculated by Citco. (*Id.* ¶ 335; GS COM-94/98 at 15-17 (Dkt. 363-7); F. Sentry PPM 07/03 at 23-27 (Dkt. 116-6); F. Sentry PPM 10/04 at 21-25 (Dkt. 363-9).) Plaintiffs had to rely on this information; Plaintiffs had no access to information through which they could independently calculate or test these reported values. Similarly, when Plaintiffs decided to invest or re-invest they had no access to

information through which they could verify the investment confirmations they received (SCAC ¶ 328); they had to accept that their investment assets purchased the number of shares reported by the Citco Administrators at the stated NAV. Moreover, in deciding whether to retain their investments, Plaintiffs had to repose their trust in the Citco Administrators' statements of their account values on an ongoing basis, which were based on the Citco Administrators' NAV calculations, as well as the other communications received from Citco about the Funds' performance. (SCAC ¶¶ 327-28.) Because Plaintiffs had no access to information through which they could independently calculate or test the values reported on their account statements, they were forced to rely on the Citco Administrators in deciding to retain their investments. (*Id.* ¶ 335.) These allegations establish that the Citco Administrators owed Plaintiffs a fiduciary duty. *See Pension Comm.*, 446 F. Supp. 2d at 196-97 (denying motion to dismiss fiduciary duty claim against Citco administrator because Citco "had superior access to confidential information regarding the Funds' NAV by virtue of its role as the Funds' administrator," Citco "held itself out to investors as having policies and procedures to ensure that the Funds' valuations would be accurate and fair," Plaintiffs relied on these representations, and Citco had failed to show that it was relegated solely to ministerial functions).

Citing *Jordan (Berm.) Investment Co. v. Hunter Green Investments LLC*, 2007 WL 2948115, at **22-23 (S.D.N.Y. Oct. 3, 2007), Defendants claim (Adm. Br. at 19-20) that any relationship was far "too attenuated" to give rise to a fiduciary duty. In *Jordan*, however, which was decided on summary judgment, the evidence established that the administrator had no contact with the plaintiff; that the plaintiff did *not* rely on the administrator's account statements; and that the administrator had not undertaken to calculate the NAV independently. *Id.* at **60-66. *Pension Comm.*, 592 F. Supp. 2d at 640, recognized the same distinction in the *Jordan* case.

Furthermore, on an earlier motion to dismiss and motion for reconsideration, the *Jordan* court held that the allegations had established a fiduciary duty between the administrator and investors. *Jordan (Berm.) Investment Co. v. Hunter Green Invsestments Ltd.*, 2003 WL 1751780, at *13 (S.D.N.Y. Apr. 1, 2003) ("It is presumed that . . . the Fund administrator[ ] had a fiduciary duty . . . to implement all trades on behalf of those shareholders and to report the status of each shareholder's account accurately."); *Jordan (Berm.) Investment Co. v. Hunter Green Investments Ltd.*, 2003 WL 21263544, at *4 (S.D.N.Y. June 2, 2003) (emphasizing that the administrator's duties, as alleged, "went beyond ministerial functions."). Plaintiffs here have similarly alleged that the Citco Administrators' duties went beyond ministerial functions. *See supra* at 4-5.

Moreover, as noted *supra* at 8-9, Plaintiffs allege that they necessarily communicated with the Citco Administrators prior to investing, contrary to Defendants' denials. (Adm. Br. at 20.) Plaintiffs were not merely a "client of a client," but instead had a direct relationship wherein the Citco Defendants' superior position and purported expertise and skill necessitated that Plaintiffs reasonably and foreseeably repose their trust and confidence in Citco, which Plaintiffs did by investing and retaining investments in the Funds. (SCAC ¶ 493.)

The Citco Administrators contend (at 18-19) that Plaintiffs' trust in them was "unilateral" and that they never accepted it. But Defendants' after-the-fact disclaimer cannot undo the fiduciary nature of the relationship, as exemplified by Citco's assurance that it would "act as a reliable fiduciary to safeguard the interests of investors." (SCAC ¶ 325.) As discussed above (at 9-10), the Citco Administrators allowed their names, duties and past NAV calculations to be set forth in the private placement memoranda for prospective investors; knowingly accepted investment monies directly from Plaintiffs; sent investment confirmations directly to Plaintiffs; continued to calculate the NAV on which they knew Plaintiffs relied to ascertain account values;

and communicated regularly with Plaintiffs as investors – all without ever disclaiming the fiduciary nature of the relationship. (SCAC ¶¶ 327, 328, 333, 342, 488-491.)

Citco now claims that describing itself "as a reliable fiduciary" in marketing materials is not sufficient to establish a fiduciary duty. The reality, however, is that the entirety of Citco's relationship with Plaintiffs, including the marketing statements, establishes that Citco is a fiduciary. The cases cited in support of Citco's marketing argument (Adm. Br. at 19) arose in starkly different circumstances. *See World Wrestling Entm't, Inc. v. Jakks Pac., Inc.*, 530 F. Supp. 2d 486, 504-5 (S.D.N.Y. 2007) (the relationship between two commercial entities was governed by a contract that did not mention a fiduciary relationship), *DeBlasio v. Merrill Lynch & Co., Inc.*, 2009 WL 2242605, at *28 (S.D.N.Y. July 27, 2009) (plaintiffs offered only the "conclusory assertion" that the defendants held themselves out as financial advisors who would be fiduciaries, and alleged no "interactions-indirect or otherwise" between plaintiffs and defendants); *Barron Partners, LP v. Lab123, Inc.*, 593 F. Supp. 2d 667, 671 (S.D.N.Y. 2009) (applying general rule that there is no fiduciary relationship between sellers and buyers of corporate stock); *Musalli*, 261 F.R.D. at 26 (applying general rule that banks do not owe fiduciary duties in a deposit or lending relationship).

Finally, a fiduciary relationship may be found in any case "in which influence has been acquired and abused, in which confidence has been reposed and betrayed." *United Feature Syndicate, Inc. v. Miller Features Syndicate, Inc.*, 216 F. Supp. 2d 198, 218 (S.D.N.Y. 2002) (*quoting Penato v. George*, 383 N.Y.S.2d 900, 904 (App. Div. 2d Dep't 1997)). That is precisely what occurred here. The Citco Administrators, by virtue of their superior position, access to confidential information, and undertaking of discretionary responsibilities, compelled Plaintiffs to repose confidence in their fiduciary relationship. (SCAC ¶¶ 492-94.) The Citco

Administrators then abused their position by failing to discharge their obligations by inaccurately calculating the Funds' NAV and communicating fictitious Fund valuations to Plaintiffs, (*id.* ¶ 495), which were central to Plaintiffs' investment decisions.[10] In addition, the Citco Administrators' superior position was augmented by the numerous responsibilities and relationships of the other Citco entities, layered on top of their role as administrators. (SCAC ¶¶ 159-61, 326, 330-35.)

2. The Citco Custodians Owed a Fiduciary Duty to Plaintiffs.

Like the Citco Administrators, the Citco Custodians only challenge part of the first element of the fiduciary duty claims – whether as custodians they owed Plaintiffs any fiduciary duty – and only do so in passing, with no citation to authority. (Cust. Br. at 18.) The Citco Custodians also owed Plaintiffs a fiduciary duty under the same legal standards discussed above (at 14-18).[11]

The Citco Custodians undertook the key responsibilities of ensuring that the securities were in the custody of Madoff as sub-custodians and of monitoring Madoff. (SCAC ¶¶ 159-60, 330.) In this capacity, they had access to confidential information, and were in a superior position to Plaintiffs, who had no ability whatsoever to obtain such information on their own or

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[10] Other cases cited by the Citco Administrators (Adm. Br. at 18-19) are inapposite. *See Thermal Imaging v. Sandgrain Sec. Inc.*, 158 F. Supp. 2d. 335, 343-44 (S.D.N.Y. 2001) (dismissing a claim based on an alleged fiduciary relationship stemming from a loan agreement or a broker/customer relationship where the alleged fiduciary had non-discretionary duties only); *Musalli*, 2009 WL 860635, at *40 (dismissing a claim based on alleged fiduciary duties by banks to non-customers, depositors, or customers in lending relationships).

[11] Courts impose fiduciary duties on custodians of assets in various other contexts. *See, e.g., In re U. S. Oil & Gas Litig.*, 1988 WL 28544, at *25 (S.D. Fla. Feb. 8, 1988) ("As these defendants were designated custodians of investor funds, they owed fiduciary duties to the investors."); *Schoenholtz v. Doniger*, 628 F. Supp. 1420, 1430 (S.D.N.Y. 1986) (custodian of a retirement plan); *Cash v. Titan Fin. Servs., Inc.*, 873 N.Y.S.2d 642, 646 (App. Div. 2d Dep't 2009) (a custodian and escrow agent responsible for the distribution of proceeds held for the benefit of others); *Grosso v. Radice*, 2009 WL 749906 (E.D.N.Y. March 16, 2009) (custodian of minors' accounts); *Underwood v. Bank of Huntsville*, 494 So. 2d 619, 620 (Ala. 1986); *Lake Worth v. First Nat'l Bank*, 93 So. 2d 49 (Fla. Sup. Ct. 1957); *In re Marriage of Petrie*, 19 P.3d 443 (Wash. App. Ct. 2001).

verify the assets. In addition, the Citco Custodians inspired trust and confidence in the Plaintiffs because they had the authority to "act without first obtaining instructions from the Fund[s]" if such action was necessary "to preserve or safeguard the Securities or other assets of the Fund[s]," and had absolute discretion to refuse to execute instructions by the Funds. (*Id.* ¶¶ 160, 330) The Citco Custodians agreed to use their best efforts and due care in the execution of these duties. (*Id.* ¶ 331.)

The Citco Custodians accepted Plaintiffs' trust by being listed in the various Fund offering documents disseminated to the investors. They were aware that existing and potential investors knew that they were providing significant services to the Funds and were relying on their reputation and expertise (*id.* ¶¶ 333-34). The Citco Custodians then abused their position of trust and confidence by, among other omissions, failing to discharge their custodial obligations, sub-delegating responsibility to BMIS as sub-custodian without supervision, and blindly and recklessly handing over Plaintiffs' assets to BMIS (*id.* ¶ 496), all despite their knowledge of the numerous red flags (*id.* ¶ 339). Therefore, Plaintiffs' allegations establish that the Citco Custodians owed Plaintiffs a fiduciary duty.

3. Plaintiffs Have Stated a Claim for Breach of Fiduciary Duty Against Citco Bermuda, Pilgrim, and Francoeur.

Citco Bermuda and the Citco Directors argue that Plaintiffs' allegations do not establish that the Citco Directors, who served as directors to the Funds' investment manager/general partner, FGBL, owed a fiduciary duty to Plaintiffs, or breached that duty. Citco Bermuda also claims that it is not liable for the conduct of its employees, the Citco Directors.

a. New York Law Governs the Claims for Breach of Fiduciary Duty Against Citco Bermuda, Pilgrim, and Francoeur.

As an initial matter, Citco Bermuda and the Citco Directors contend that Bermuda law

governs the breach of fiduciary duty claim, because the claim implicates the internal affairs of FGBL, which is incorporated in Bermuda.[12] (Citco Ber. Br. at 6; Francoeur Br. at 5.) Defendants' reliance on the internal affairs doctrine is misplaced, because Plaintiffs are shareholders in the FGG Funds, not FGBL; thus, the internal affairs of FGBL are not implicated. *See, e.g., Roselink Investors, L.L.C. v. Shenkman*, 386 F. Supp. 2d 209, 225 (S.D.N.Y. 2004) (citing *First Nat'l City Bank v. Banco para el Comercio Exterior de Cuba,* 462 U.S. 611, 621 (1983).[13] In contrast, the cases cited by Defendants (Citco Ber. Br. at 6; Francoeur Br. at 5) all fundamentally relate to shareholders suing a corporation or its own officers.[14]

Accordingly, traditional New York conflict of laws analysis for torts, which considers which jurisdiction has the "greatest interest" in the litigation, applies. *See, e.g., PPI Enters (U.S.), Inc.*, 2003 WL 22118977, at *19; *Roselink*, 386 F. Supp.2d at 225.[15] New York has the

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[12] Francoeur also argues that Delaware law is potentially dispositive of the claim for breach of fiduciary duty, by reference to the FGG Defendants' Brief. (Francoeur Br. at 6; FG Defs. Br. at 59). Plaintiffs hereby incorporate their responses to the referenced FGG Defendants' arguments. *See* FGG Opp. Br. at Point IIC. In addition, New York law applies to the claims against Francoeur for all the same reasons it applies to the claims against Pilgrim, set forth herein (at 20-21).

[13] *See also PPI Enters. (U.S.), Inc. v. Del Monte Foods Co.*, 2003 WL 22118977, at *19 (S.D.N.Y. Sept. 11, 2003) (rejecting the application of internal affairs doctrine to investor claims against corporation's financial advisor because "no corporate, contractual, or statutory relationship" existed between the two parties and plaintiff's claims were "separate and distinct" from its relationship with the corporation); *In re Adelphia Commc'ns. Corp.*, 365 B.R. 24, 39-41 (Bankr. S.D.N.Y. 2007) (quoting *Edgar v. MITE Corp.*, 457 U.S. 624, 645 (1982)) (internal affairs doctrine inapplicable where "claims do not involve 'matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders'").

[14] *See Winn ex rel. Scottish RE Group Ltd. v. Schafer*, 449 F. Supp. 2d 390 (S.D.N.Y. 2007) (shareholder derivative action); *Galef v. Alexander*, 615 F.2d 51 (2d Cir. 1980) (corporation suing its own officer); *Seybold v. Groenink*, 2007 WL 737502 (S.D.N.Y. Mar. 12, 2007) (same, and specifically distinguishing direct shareholder actions, where the internal affairs doctrine would not apply). *See also BBS Norwalk One, Inc. v. Raccolta, Inc.*, 60 F. Supp. 2d 123, 129 (S.D.N.Y. 1999) (corporation suing third parties for aiding and abetting its own director's breaches of fiduciary duty) (*compare In re Adelphia Commc'ns. Corp.*, 365 B.R. 24, 39-40 (reconciling seeming split of authority on choice of law for aiding and abetting claims and holding that normal "interest analysis" principles apply to claims for aiding and abetting breaches of fiduciary duty, warranting application of the law of the jurisdiction with the greatest interest in a particular case); *LaSala v. UBS, AG*, 510 F. Supp.2d 213, 231 n.9 (S.D.N.Y. 2007) (same)).

[15] Indeed, even if the internal affairs of FGBL were implicated, a New York court would still apply New York law as the state with the "overriding interest" in the claims, as compared to Bermuda. Federal

greatest interest in this action, and therefore, the law of New York applies. Much of the tortious activity surrounding the management of the Funds occurred in New York. *See* FGG Opp. Br. at Point IIA.[16] Likewise, the information which the Citco Defendants failed to verify, in breach of their fiduciary and other duties, issued from Madoff in New York. (SCAC ¶ 157-60). *See, e.g., Pension Comm.*, 446 F. Supp. 2d 163, 194 (applying New York law to breach of fiduciary duty claims against the Citco defendants and fund directors, instead of internal affairs doctrine, because "New York has a strong interest in applying its law with respect to defendants who aid and abet torts masterminded and executed by hedge fund managers from within the state, and who breach their fiduciary duties, to serve as a check against such misconduct," and because "the breach of fiduciary duty relates to the Citco Defendants' failure to independently verify false information issued to them from Lauer and Lancer Management in New York.").[17] Furthermore, Pilgrim is no longer a director of FGBL (*id.* ¶ 164), so is not at risk of being faced with inconsistent obligations in Bermuda.

Citco Bermuda and the Citco Directors also contend that the law of Bermuda should be applied under the investment management agreements between FGBL and the funds, which contain a Bermuda choice of law provision. (Citco Ber. Br. at 6; Francoeur Br. at 5.) To the contrary, the contractual choice of law provisions in the FGBL-Fund contract are not applicable to tort claims between Plaintiffs and the Citco Directors, where neither were parties to the

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courts in this district have rejected "any automatic application" of the internal affairs doctrine, instead applying the law of the state with the "overriding interest" in the issue to be decided. *Pension Comm.*, 446 F. Supp. 2d at 192; *Stephens v. Nat'l Distillers and Chem. Corp.*, 1996 WL 271789, *4-5 (S.D.N.Y. 1996).

[16] Plaintiffs incorporate herein by reference all applicable arguments in the FGG Opposition Brief and the PwC Opposition Brief.

[17] Notably, in *Pension Committee*, the directors being sued had been directors of the *fund*, and the plaintiffs were shareholders in *that fund*, so there was a stronger argument there for application of the internal affairs doctrine than here.

contract. *See, e.g., Hong Kong and Shanghai Banking Corp. Ltd. v. HFH USA Corp.*, 805 F. Supp. 133, 139-49 (W.D.N.Y. 1992) (choice of law provision that "operated to the detriment" of non-parties not applied). In addition, contractual choice of law provisions generally do not govern non-contractual causes of action. *See Rosenberg v. Pillsbury Co.*, 718 F. Supp. 1146, 1150 (S.D.N.Y. 1989); *Fin. One Public Co. Ltd. v. Lehman Bros. Special Fin., Inc.*, 414 F.3d 325, 335 (2d Cir. 2005) "Under New York law . . . tort claims are outside the scope of contractual choice-of-law provisions that specify what law governs construction of the terms of the contract . . . ."). *See also infra* at 62.

Accordingly, New York law applies to the breach of fiduciary duty claims against Citco Bermuda and the Citco Directors.

b. The Citco Directors Owed Fiduciary Duties To Plaintiffs.

Defendants further contend that, even if New York law applies, the Citco Directors owed no fiduciary duty to Plaintiffs. (Citco Ber. Br. at 7; Francoeur Br. at 5.) Under the applicable legal standard, *supra*, at 14-15, Plaintiffs have established that the Citco Directors owed fiduciary duties to Plaintiffs. Plaintiffs allege that Francoeur and Pilgrim served as members of FGBL's Board of Directors. (SCAC ¶¶ 163-64, 559-60.) Plaintiffs also allege that FGBL's Board of Directors had responsibility for FGBL, which in turn had day-to-day management responsibility for the Funds, including selecting and monitoring the Fund's investments and investment advisors and maintaining relationships between the Funds and their advisors, custodians, administrators, and transfer agents. (*Id.* ¶¶ 559-61.) These allegations are sufficient to establish a fiduciary duty. Furthermore, the Citco Directors owed Plaintiffs a fiduciary duty for the same reasons that FGBL and FGG's principals owed Plaintiffs a fiduciary duty. *See* FGG Opp. Br. at Point IIC. Contrary to Francoeur's argument (Francoeur Br. at 6), it is clear that as

director of the general partner (FGBL) of a limited partnership (Greenwich Sentry and Greenwich Sentry Partners).

Moreover, it is clear that Francoeur owed fiduciary duties to Plaintiffs, as limited partners in the partnership. *See In re Kingston Square Assocs.*, 214 B.R. 713, 735-36 (Bankr. S.D.N.Y. 1997) (finding it "inconceivable" that defendant director of general partner would not understand fiduciary obligations to limited partners); *Tobias v. First City Nat'l Bank and Trust Co.*, 709 F. Supp. 1266, 1277 (S.D.N.Y. 1989) (limited partner stated claim for breach of fiduciary duty against director of general partner); *Crossen v. Bernstein*, 1994 WL 281881, at *4 (S.D.N.Y. 1994) (allegations that defendants were directors of general partner of limited partnership in which plaintiff invested established fiduciary relationship). The result should be no different in terms of Pilgrim and Francoeur's obligations to shareholders in Fairfield Sigma and Fairfield Sentry. *Cf. Tucker Anthony Realty Corp. v. Schlesinger*, 888 F.2d 969, 973 (2d Cir. 1989) ("New York makes no distinction between the fiduciary duty owed by a general partner and that owed by a corporate director . . . . Both are bound by the same rule of fair-dealing with limited partners or shareholders who rely on the integrity of the general partner and corporate directors who are empowered . . . to manage the business into which those passive investors have placed their funds.").[18]

Cases cited by Defendants regarding the existence of a fiduciary duty are inapposite. (Citco Ber. Br. at 7-8, Francoeur Br. at 5.) *A.I.A. Holdings, S.A. v. Lehman Brothers, Inc.*, 1999 WL 47223 (S.D.N.Y. Feb. 3, 1999), was decided in the context of fraud perpetrated by a broker and an investment advisor. *Renner v. Chase Manhattan Bank*, 2000 WL 781081 (S.D.N.Y. June

[18] The Citco Directors' fiduciary duties flow from public policy, not the parties' contract. *See Bullmore v. Banc of Am. Secs. LLC.*, 485 F. Supp. 2d 464, 470 (S.D.N.Y. 2007). Therefore, Francoeur's defense (at 6) that the Limited Partnership Agreements protect directors from a breach of fiduciary duty claim is also misplaced.

16, 2000), similarly involved a fiduciary duty claim against a securities broker. Any duties of brokers and investment advisors, who are generally involved only at the point of the initial investment, are not germane to the fiduciary responsibilities of corporate directors, who have ongoing duties and obligations.

c. The Citco Directors Breached Their Fiduciary Duties To Plaintiffs.

Defendants also contend that Plaintiffs' allegations do not establish breaches of their fiduciary duties to Plaintiffs. (Citco Ber. Br. at 8; Francoeur Br. at 5.) To the contrary, Plaintiffs allege that the Citco Directors breached their fiduciary duties by failing to supervise the Funds' advisor (*i.e.*, Madoff) or the investments that were entrusted to Madoff, and in failing to pursue red flags that should have alerted them to the presence of unlawful activity. (SCAC ¶¶ 562.) These allegations are sufficient to establish breach. *See, e.g., Automatic Catering, Inc. v. First Multifund for Daily Income Inc.*, 1981 WL 1664 (S.D.N.Y. Aug. 3, 1981) (denying summary judgment motion based on allegations that an investment manager and its directors breached fiduciary duty of managing, selecting, and supervising the assets of a fund, instead making omissions or misrepresentations concerning the fund's investment strategy).[19]

d. Citco Bermuda Is Liable Under the Respondeat Superior Doctrine.

Citco Bermuda contends that even if its employees Pilgrim and Francoeur breached their fiduciary duties, Citco Bermuda is not liable for their conduct, because they were acting as directors of another company, FGBL. (Citco Ber. Br. at 12-13; *see also* Cust. Br. at 24-25; Citco

[19] *Moscato v. TIE Techs., Inc.*, 2005 WL 146806 (S.D.N.Y. Jan. 21, 2005) (Citco Berm. at 9) is inapposite to this element, because the court found that plaintiff had failed to allege the existence of a fiduciary duty by stock issuers, stock transfer company, and the issuers' common director, so the court did not proceed to the analysis of any alleged breach.

Group Br. at 21.) This argument ignores ancient principles of *respondeat superior.*[20] Citco Bermuda directed Pilgrim and Francoeur to "serve as directors of FGBL within the scope of their employment." (*Id.* ¶ 161.) Each served as a director of FGBL "as part of his duties and responsibilities as an employee and officer of CFSB." (*Id.* ¶¶ 163-64, 559-60.) FGBL paid Citco Bermuda for their services. (*Id.*) Moreover, in providing the services of its employees to FGBL, Citco Bermuda was acting to solidify the relationship of the Citco companies with FGG, an important customer that paid substantial services fees to the Citco Administrators and Custodians. (SCAC ¶¶ 343, 564.)[21] As investment manager of the funds, FGBL had the authority to select the Funds' administrator and custodian – and thus, to keep the Citco Administrators and Custodians installed in these lucrative positions. (*Id.* ¶ 119.) These allegations are sufficient to establish that the Citco Directors were acting as directors for FGBL within the scope of their employment for Citco Bermuda, and in furtherance of their duties of Citco Bermuda, and thus, that Citco Bermuda is liable under the doctrine of *respondeat superior.* *See Riviello v. Waldron*, 47 N.Y.2d 297, 302 (N.Y. 1979 ("[T]he test [for respondeat superior] has come to be 'whether the act was done while the servant was doing his master's work, no matter how irregularly, or with what disregard of instructions.'"); *Lundberg v. State*, 25 N.Y.2d 467, 470 (N.Y. 1969) ("An employee acts in the scope of his employment when he is doing something in furtherance of the duties he owes to his employer and where the employer is, or could be, exercising some control, directly or indirectly, over the employee's activities.").

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[20] Citco Bermuda is also liable because of the agent-principal relationship of the Citco entities to each other (as discussed in Point IV, *infra*).

[21] It is irrelevant that Citco Bermuda did not contract with the Funds. The agreements that the Citco Administrators and Citco Custodians entered with the Funds provide that services may be provided by Citco Group and any of its companies – not just the company specifically engaged. (SCAC ¶ 323.) Citco's marketing materials also tout the interchangeability of its staff between its individual companies. (*Id.*) The service of Citco Bermuda employees as directors reflects this interchangeability of the Citco companies and staff.

Citco Bermuda suggests (at 12) that a company which directs its employees to serve as directors to another company can never be liable for the conduct of the director-employees under respondeat superior, because, as directors, they are serving the other company. Citco's argument makes no sense. The doctrine of *respondeat superior* makes a company liable for the torts of its employees, acting within the scope of their employment, whether they are driving a truck or managing someone else's business. This is particularly true where, as here, the company employing the directors was acting to solidify its already complex and lucrative relationship with the other company, and entrench itself within that company, and where Citco Bermuda was itself paid by FGG for providing the services of the employees.[22]

Citco Bermuda questions (at 13) whether Pilgrim or Francoeur were acting as its agents, but factual questions regarding whether employees were acting within the scope of their employment cannot be resolved on a motion to dismiss. *See, e.g., Armstrong v. McAlpin*, 699 F.2d 79, 92 (2d Cir. 1983) (holding on motion to dismiss that determination of liability of two alleged employers "as principals under the common law of agency" must "await further factual development"); *Zaro v. Mason*, 658 F. Supp. 222, 228 (S.D.N.Y. 1987) (denying summary judgment because determination of respondeat superior liability "would require the resolution of factual questions concerning the scope of employment of the third-party defendants, and whether their acts were within the scope of their employment"); *Quadrozzi v. Norcem, Inc.*, 509 N.Y.S.2d 835, 836 (App. Div. 2d Dep't 1986) ("Because the determination of whether a particular act was

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[22] *In re Global Crossing, Ltd. Securities Litigation*, 2005 WL 1881514 (S.D.N.Y. Aug. 5, 2005) and *In re Global Crossing, Ltd. Securities Litigation*, 2005 WL 2990646 (S.D.N.Y. Nov. 7, 2005) (Berm. Br. at 12) are not to the contrary. The defendants had appointed directors to another company under their right to do so as minority shareholders; they were not providing a service to a customer. Nor were the defendants otherwise providing services to the second company, which did not pay defendants for the services of their employees as directors, unlike the situation here. In addition, the court noted that the plaintiffs were trying to use respondeat superior to establish liability for direct federal securities fraud claims; in contrast, here Plaintiffs are seeking to establish liability for common law torts.

within the scope of the servant's employment is so heavily dependent on factual considerations, the question is ordinarily one for the jury.").

C. Plaintiffs Have Stated Claims for Aiding and Abetting Fraud and Aiding and Abetting Breach of Fiduciary Duty.

The Citco Administrators and the Citco Custodians contend that Plaintiffs' allegations fail to establish claims for aiding and abetting the Fairfield Defendants' fraud and breach of fiduciary duty. (Adm. Br. at 23-24; Cust. Br. at 19-21). To state a claim for aiding and abetting a breach of fiduciary duty, a plaintiff must show: "(1) breach of fiduciary obligations to another of which the aider and abettor had actual knowledge; (2) the defendant knowingly induced or participated in the breach; and (3) plaintiff suffered actual damages as a result of the breach." *Kottler v. Deutsche Bank AG*, 607 F. Supp. 2d 447, 466 (S.D.N.Y. 2009). Similarly, to state a claim for aiding and abetting fraud, a plaintiff must show: "(1) the existence of an underlying fraud; (2) knowledge of this fraud on the part of the aider and abettor; and (3) substantial assistance by the aider and abettor in achievement of the fraud." *Kottler*, 607 F. Supp. 2d at 464. The Citco Defendants dispute only the knowledge element – whether the allegations sufficiently establish knowledge of the breach of fiduciary duty or fraud by the Citco Defendants.[23]

The knowledge requirement can be satisfied by a "reasonable inference of actual knowledge," and is not identical to the scienter required for the underlying fraud. *See Pension Comm. of Univ. of Montreal Pension Plan v. Banc of Am. Sec., LLC*, 652 F. Supp. 2d 495, 502-3 (S.D.N.Y. 2009). Willful blindness or conscious avoidance is sufficient. *See, e.g., Fraternity Fund Ltd. v. Beacon Hill Asset Mgmt., LLC*, 479 F. Supp. 2d 349, 370 (S.D.N.Y. 2007) ("[T]he Court sees no reason to spare a putative aider and abettor who consciously avoids confirming

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[23] Plaintiffs' claim for aiding and abetting breach of fiduciary duty claim is governed by Rule 8 pleading standard, *Musalli Factory for Gold & Jewellry v. JPMorgan Chase Bank, N.A*, 261 F.R.D. 13, 23-24 (S.D.N.Y. 2009), while Plaintiffs' claim for aiding and abetting fraud is governed by Rule 9.

facts that, if known, would demonstrate the fraudulent nature of the endeavor he or she substantially furthers."). In any event, however, Plaintiffs demonstrated actual knowledge.[24]

Plaintiffs allege that the Citco Defendants had actual knowledge that the Fairfield Defendants' owed fiduciary duties to Plaintiffs, and that the Fairfield Defendants were breaching those duties by employing due diligence and risk controls on the Funds' investments that were grossly deficient. (SCAC ¶¶ 511-12.) Plaintiffs further allege that the Citco Defendants had actual knowledge that the Fairfield Defendants were making false representations to Plaintiffs that they had undertaken meaningful due diligence and implemented risk controls, and the Fairfield Defendants were failing to disclose the clear deficiencies in their internal controls and monitoring of Madoff. (*Id.* ¶¶ 517-18.) Plaintiffs allege that the Citco Defendants acquired such knowledge through Citco's position as a leading provider of services to the hedge fund industry, and the Citco Defendants' long-standing relationship with and knowledge of the Funds' operations, as administrator, custodian, bank and depositary. (*Id.* ¶¶ 512, 518.) In addition, Plaintiffs allege that the Citco Defendants were aware of the misconduct of the Fairfield Defendants because of the red flags surrounding Madoff, including the lack of any transparency into Madoff's operations (*id.* 218), his family members' involvement in key positions at his firm (*id.* ¶ 220), his lack of segregation of important functions (*id.* ¶ 221), his use of an unknown auditing firm (*id.* ¶ 222), his use of paper trading records (*id.* ¶ 223), and his implausibly consistent investment returns (*id.*), as well as the consolidation of the roles of investment manager, custodian and execution agent in Madoff. (*Id.* ¶ 524.) Moreover, Plaintiffs allege that

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[24] Even where Rule 9(b) is applicable, a "more general standard of scienter is applicable" when pleading state of mind, because "a plaintiff realistically cannot be expected to plead a defendant's actual state of mind." *Rosner v. Bank of China*, 528 F. Supp. 2d 419, 425 (S.D.N.Y. 2007) (*citing Wight v. BankAmerica Corp.*, 219 F.3d 79, 91 (2d Cir. 2000)). In fact, "[a]ctual knowledge of the fraud may be averred generally." *In re Worldcom, Inc. Sec. Litig.*, 382 F. Supp. 2d 549, 560 (S.D.N.Y. 2005) (internal quotation marks omitted).

the Citco Defendants were obligated, among other duties, to independently calculate the NAVs and to monitor Madoff as a sub-custodian. (*Id.* ¶ 335.)

These allegations are sufficient to establish knowledge for purposes of the aiding and abetting claim. *See Pension Comm. of Univ. of Montreal Pension Plan v. Banc of Am. Sec., LLC*, 2007 WL 528703, at *7 (S.D.N.Y. Feb. 20, 2007) (denying motion to dismiss the aiding and abetting breach of fiduciary duty and fraud claims against Citco administrator, and holding "actual knowledge" requirement satisfied where there was "circumstantial evidence" giving rise to an "inference of knowledge," such as the series of "red flags" that the Citco Defendants allegedly ignored); *Pension Comm.*, 652 F. Supp. 2d 495, 504 (S.D.N.Y. 2009) (denying motion for summary judgment by fund's prime-broker/custodian on aiding and abetting claim, because a reasonable jury could infer that the custodian had actual knowledge from circumstantial evidence, such as evidence that the custodian was instructed to include in its position reports certain transactions that were "too good to be true" and other inconsistencies in the trades and values it reported). As in the *Pension Committee* decisions, Plaintiffs here have alleged both actual knowledge and circumstances from which such knowledge can be inferred – including the numerous red flags, the long-standing involvement of the Citco Defendants in the Funds, and the service of Citco employees Pilgrim and Francoeur as directors of FGBL, as well as the Citco Defendants' duties to verify the information they received and reported, and to monitor Madoff. (SCAC ¶¶ 157-60, 163-64, 217-23, 332-35.)

Musalli, 261 F.R.D. 13 (Cust. Br. at 21), is distinguishable because there it was alleged only that the defendants "knew, or should have known" of the improper conduct, and plaintiff failed to explain *how* the defendants would have known that the conduct (certain bank transfers)

was improper. *Id.* at 24.[25] In contrast, Plaintiffs allege that the Citco Defendants *knew* of the Fairfield Defendants' wrongful conduct, and explain how the Citco Defendants came to know of the improper conduct by the Fairfield Defendants. (SCAC ¶¶ 341, 511-12, 517-18.)

The Citco Defendants contend that *Musalli* stands for the proposition that allegations of "collective knowledge" are insufficient. However, Plaintiffs are not relying on "collective knowledge" and the complaint alleges knowledge by each Citco entity. The term "Citco" is defined as each of the Citco Defendants; thus, when making allegations against Citco, Plaintiffs allege that *each* of the Citco Defendants individually had the requisite knowledge. The complaint goes on to explain that such knowledge was gained by virtue of the specific services provided by the administrator, custodian, bank, and depositary entities (*i.e.*, Citco Fund Services, Citco Canada, Citco Bank, and Citco Global), and also alleges that two of Citco Bermuda's employees served as directors for one of the Fairfield Defendants that engaged in the primary misconduct. (SCAC ¶¶ 163-64.) Furthermore, just as a corporation may be charged with the knowledge of its employees, *Musalli*, 261 F.R.D. at 23-25, Citco Group and the unified "Citco Fund Services" division may be charged with the knowledge of its subparts.

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[25] Far weaker allegations explain and distinguish other cases cited by the Citco Defendants as well. In *Rosner v. Bank of China*, 528 F. Supp. 2d 419, 426 (S.D.N.Y. 2007) (Cust.Br. at 20), the court found allegations insufficient where plaintiff merely alleged that a defendant's employee "would have" or "must have" had knowledge of the misconduct. In *Abu Dhabi Commercial Bank v. Morgan Stanley & Co.*, 651 F. Supp. 2d 155, 187 (S.D.N.Y. 2009) (Citco Bank & Cust. Br. at 20), the only facts alleged were that a bank was compensated for ascertaining the value of a fund's assets, the compensation was based on the market value of those assets, the bank was responsible for marking to market all of the fund's assets on a daily basis, and the bank had participated and approved the selling documents that had been distributed for the fund. Even weaker allegations were dismissed in *Filler v. Hanvit Bank*, 156 Fed. App'x 413, 417 (2d Cir. 2005), involving allegations that a defendant had helped a company falsify its revenues and transmitted it to an accountant, without alleging any connection to the allegedly false financial statements made by an affiliated company that was accused of perpetrating fraud. Similarly, in *Rand Int'l Leisure Products, Inc. v. Bruno*, 875 N.Y.S.2d 823, 2009 N.Y. Slip Op. 50085U, at *4 (N.Y. Sup. Ct. 2009), plaintiffs had made only "nebulous and unelaborated claims" that a defendant had "supported" another's tortious conduct by providing financial support, without indicating that defendant knew or had reasons to suspect the underlying conduct.