UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

PASHA S. ANWAR, *et al.*, Plaintiffs, v. FAIRFIELD GREENWICH LIMITED, *et al.*, Defendant. This Document Relates To: All Actions	Master File No. 09-cv-118 (VM)

PLAINTIFFS' CONSOLIDATED OPPOSITION TO
THE PwC DEFENDANTS' MOTIONS TO DISMISS

BOIES, SCHILLER & FLEXNER LLP
575 Lexington Avenue
New York, NY 10022
(212) 446-2300

WOLF POPPER LLP
845 Third Avenue
New York, NY 10022
(212) 759-4600

LOVELL STEWART HALEBIAN JACOBSON LLP
61 Broadway, Suite 501
New York, NY 10006
(212) 608-1900

Interim Co-Lead Counsel for Plaintiffs

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Plaintiffs submit this Consolidated Opposition to the PwC Defendants' Motions to Dismiss.[1]

PRELIMINARY STATEMENT

PwC[2] audited the Fairfield Funds[3] from 1993 to 2008. In each of those years, PwC issued clean opinions, certifying that the Funds' financial statements accurately represented their financial condition. PwC addressed the audit reports directly to the partners and shareholders of the Funds—the Plaintiffs. PwC did so because it expressly recognized that it was "responsible for reporting to the … shareholders and/or partners on the financial statements of the Funds." (SCAC ¶ 276, quoting from PwC's Audit Plan at 8.)[4] PwC further acknowledged that a purpose

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[1] The briefs of the PwC Defendants (*i.e.*, PricewaterhouseCoopers Accountants N.V. ("PwC Netherlands"), PricewaterhouseCoopers LLC ("PwC Canada"), and PricewaterhouseCoopers International Limited ("PwC International")) to which Plaintiffs respond are: the *Memorandum of Defendant PricewaterhouseCoopers Accountants N.V. in Support of its Motion to Dismiss the Second Amended Complaint* (the "PwC Netherlands Brf."), *Memorandum in Support of PricewaterhouseCoopers LLP's Motion to Dismiss* (the "PwC Canada Brf."), and the *Memorandum in Support of PricewaterhouseCoopers International Limited Motion to Dismiss* (the "PwC International Brf.),

[2] Defendants PwC Netherlands, PwC Canada and PwC International are collectively referred to as "PwC."

[3] The Fairfield Funds are the Fairfield Sentry Limited ("Fairfield Sentry"), Fairfield Sigma Limited ("Fairfield Sigma"), Greenwich Sentry, L.P. ("Greenwich Sentry"), and Greenwich Sentry Partners, L.P. ("Greenwich Sentry Partners") (collectively the "Funds").

[4] References to "SCAC" are to the Second Consolidated Amended Complaint. References to PwC's Audit Plan are to the document issued by PwC to the Fairfield Greenwich Group with respect to the Funds and entitled "Report to the Investment Manager on the Audit Plan for the year ending December 31, 2008," referenced at ¶¶ 76-277, 284, 287-288, 306-307, 309. A copy of the Audit Plan is appended to the Declaration of Howard L. Vickery dated March 22, 2010 ("Vickery Decl.") as Exh. 1. Although the Audit Plan referenced is for the year ending December 31, 2008, it sets out PwC's view of its obligations and duties as the Funds' auditor and it allows a reasonable inference that PwC held the same view of its obligations and the purpose of its audits during the entire period it audited the Funds. Presumably, PwC has in its possession the audit plans for other years and will produce them in discovery.

of its "audit engagement" was to provide "shareholders and other stakeholders" in the Funds "independent opinions and reports that provide assurance on financial information released by the funds." (Audit Plan at 8.)

Thus, as recognized by PwC in the Audit Plan, the "end and aim" of the PwC audit was to assure investors that the assets of the Funds existed and were worth what the FGG Defendants represented they were in the financial statements. Absent PwC's seal of approval, that objective would not have been met and the Funds would thus not have been marketable.

Despite its acknowledged obligation to the investors in the Funds, PwC failed abysmally in its role as auditor. Turning a blind eye to obvious red flags and failing to investigate the doubtful, PwC egregiously failed to conduct an audit in compliance with accepted auditing standards, although it claimed that compliance was a "given" because those standards served only as "the expected performance baseline for everything we do." (SCAC ¶¶ 293-94.) PwC touted its "audit approach [as being] at the leading edge of best practice." (*id*.) Yet it violated a cardinal rule of audit practice by failing to confirm that the FGG Defendants had proper controls in place to monitor the investments entrusted to Madoff or that the claimed investments existed. Instead, it complacently relied on assurances from Madoff and the FGG Defendants that the purported assets actually existed and were properly valued on the financials.

If PwC had probed at all, it would have realized that the FGG Defendants did not have a clue how Madoff implemented his black box split strike conversion strategy, how he managed to generate steady profits year after year (in up markets and down markets), or, critically, whether the claimed investments had even been made. Most importantly, PwC would have discovered the assets it affirmed to investors existed and were valued in the billions of dollars in fact did not even exist.

PwC's "defense" that it was simply one of many deceived by Madoff, as were the investors and even the SEC, ignores its role as an auditor and its acknowledged obligation to the Plaintiffs. Unlike Plaintiffs—investors who depended on PwC—PwC was paid (from Plaintiffs' investments) to conduct proper audits that would provide "assurance" to Plaintiffs about the accuracy of the Funds' financial statements. Nor does PwC gain by comparing itself to the SEC, which has admitted that, like PwC, it similarly ignored "significant red flags," "never properly examined or investigated Madoff," and failed to take "necessary, but basic steps, to determine if Madoff was operating a Ponzi scheme."[5]

Indeed, as the SCAC alleges in exhaustive detail, PwC did not display the professional skepticism required of an auditor under the circumstances, recklessly failed to conduct necessary audit procedures, and willfully ignored red flags that should have triggered investigation. In truth, PwC did not so much conduct an audit as rubber-stamp without any attempt to verify the financial statements prepared for the Funds by the Citco defendants, based on bogus figures provided by Madoff. The specific allegations in the SCAC that PwC was reckless in carrying out its so-called audits (including repeatedly failing to follow even basic auditing procedures) and disregarded red flags that compelled it to investigate are more than sufficient to support the assertion that PwC was either reckless or deliberately blind in conducting its sham audits.

[5] Report of Investigation, United States Securities and Exchange Commission, Office of Inspector General, Case No. OIG-509, August 31, 2009 ("Inspector General's Report") at 39. The Inspector General's Report is *available at www.sec.gov/news/studies/2009/oig-509 .pdf*. A copy of the Inspector General's Report is attached to the Michael Thorne Declaration dated December 22, 2009 ("Thorne Decl.") as Exh. 14.

STATEMENT OF FACTS

PwC was the auditor for the Funds beginning in 1993[6] and continuing until December 11, 2008, when Bernard Madoff confessed to the world that he had been running a Ponzi scheme of historic proportions. At the times relevant to the SCAC, the audits were performed by PwC Netherlands and PwC Canada, acting as members and under the direction of PwC International, the governing body of the worldwide PwC accounting firm. (SCAC ¶¶ 153-155.)[7]

PwC does not contend (correctly) that the Funds were required to have their financial statements audited.[8] *See also* Affidavit of Lewis Hunte, Q.C. dated March 19, 2010 on B.V.I. law ("Hunte Affidavit"), ¶27 (B.V.I. law did not require that Sentry and Sigma Funds' financial statements be audited and certified each year by an independent accounting firm). Rather, the FGG Defendants chose to have the audits performed in order to induce investors to purchase and retain interests in the Funds, giving them a patina of legitimacy.

The indisputable fact is that the Funds could not have been marketed without clean audit statements from a reputable accounting firm. PwC knew that, and allowed its name to be disclosed to potential investors in the Funds' offering documents. Moreover, PwC was fully aware that the primary purpose of its audits was to provide investors in the Funds with independent assurances that the Funds' assets were legitimately invested and accurately valued

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[6] Press reports indicate that PwC began to audit the Fairfield Sentry Fund, the oldest of the Funds, in 1993. "Fairfield Greenwich Says that Madoff Provided Bad Data," WALL STREET JOURNAL, March 2, 2009. A copy of this article is appended to the Vickery Decl. at Exh. 2.

[7] PwC Netherlands audited Fairfield Sentry's financial statements for the years 2002, 2003, 2004 and 2005; Fairfield Sigma's financial statements for the years 2003, 2004 and 2005; and Greenwich Sentry's financial statements for the year 2005. SCAC ¶¶155, 261, 263 and 265.

[8] "Unlike registered investment companies, there is no statutory or regulatory requirement that a hedge fund have its financial statements audited. Whether a hedge fund undergoes an annual audit of its financial statements is a contractual matter between the hedge fund and its investors." Implications of the Growth of Hedge Funds, Staff Report to the United States Securities and Exchange Commission

(SCAC ¶270). And it cannot be seriously disputed that PwC knew investors would rely on its audit reports in acquiring and holding shares or partnership interests in the Funds (*id*. ¶¶275, 277, 279). PwC thus addressed its financial statements to the shareholders and partners of the Funds (*id*. ¶275). The reason for that is made clear in its Audit Plan, where PwC acknowledged it was "responsible for reporting to the … shareholders and/or partners on the financial statements of the Funds . . ." in order to provide them with "assurance" concerning the accuracy of the Funds' financial statements. (SCAC ¶ 276, Audit Plan at 8.)

PwC's exposure and access to Madoff was not limited to its audits of the Funds. PwC was also the auditor for at least eight other "feeder funds" to Madoff, including the Optimal Strategies U.S. Equity Ltd., Kingate Global Fund, and Thelma International Fund, among the largest of the investors who were tricked into entrusting funds to Madoff (SCAC ¶ 271). Combined with the Funds, the feeder funds audited by PwC nominally had $16.9 billion dollars invested with Madoff as of 2007 (SCAC ¶ 274). PwC's engagement as the auditor of multiple Madoff feeder funds was a lucrative source of income, and it is a fair inference that PwC had strong financial incentives not to jeopardize its position by asking Madoff hard questions and insisting on meaningful answers.

In April 2007, PwC published a fifty-page guide for auditing hedge funds entitled "Auditing Alternative Investments – a Practical Guide for Investor Entities, Investee Fund Managers and Auditors" ("PwC Guide") (SCAC ¶292) (a copy of the PwC Guide is appended as Exh. 7 to the Vickery Decl.). The PwC guide counsels auditors of hedge funds to monitor press reports for significant developments regarding clients. As the long-time auditor of the Funds, PwC was required to consider doubts concerning Madoff which were widely publicized in the

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(September 2003) at 57 (relevant portions of the Staff Report are appended to the Vickery Decl. as Exh.

May 2001 Mar/Hedge article by Michael Orcant entitled: "Madoff Tops the Charts/Skeptics Ask How" (Vickery Decl., Exh. 4) and the "Don't Ask, Don't Tell" article by Erin Arvedlund in Barrons that same month (*Id.*, Exh. 5). The questions raised in the Mar/Hedge and Barrons articles about Madoff's investment success and his insistence on secrecy should have put PwC on heightened alert and resulted in it instituting more stringent auditing procedures to verify the existence of the Funds' assets entrusted to BMIS.

In a rare meeting with PwC in December 2004, Madoff told the PwC representatives that "99% of all trades are electronic, therefore records are updated daily and all reconciliations are performed daily (automated process)" (SCAC ¶272, PwC Memorandum on Meeting with Madoff in December 2004 ("PwC Report") at 1, Vickery Decl., Exh. 6). Yet PwC knew from its access to the Funds' records that the Funds were only provided with easy-to-forge delayed paper confirmations without time stamps or individualized prices for each trade (even though Madoff and his firm were instrumental in establishing and promoting high-tech electronic exchanges) (*id.*). This glaring anomaly between trades being made electronically and reconciliations being done automatically, on the one hand (as was the custom in the securities industry), and the unavailability of computerized confirmations on the other, was simply ignored and not investigated by PwC.

The risk of fraud in the lightly-regulated hedge fund industry was well known to PwC, which marketed its "leadership position" in auditing investment funds.[9] (SCAC ¶ 292.) The

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[9] PwC was the auditor of two earlier fraudulent hedge funds that collapsed – the Lancer funds (2003) and the Lipper funds (2002). From recent experience, it had every reason to be wary when auditing hedge funds.

introduction to the PwC Guide declares that PwC is "uniquely qualified to provide leadership" in the auditing of hedge funds for both investors and investee funds.

The PwC Guide emphasizes that the existence and valuation of investments is the *raison d`être* for auditing funds: "The main focus of the new guidance is as follows – with respect to existence, the question is: Do the investor entity's alternative investments exist at the financial statement date, and have the related transactions occurred during the period . . . With respect to valuation, the question is: Are the alternative investments stated in the investor entity's financial statements at fair value." (PwC Guide at 1).[10]

Citing the American Institute of Certified Public Accountant's ("AICPA") publication "Alternative Investments – Audit Considerations," the PwC Guide recognizes that, to guard against this high risk of fraud, auditors must confirm the holdings of the alternative investments on a security-by-security basis and that, even then, the auditor may need to perform additional procedures, depending on the significance of the alternative investments to the investor entity's financial statements. (PwC Guide at 24). Of course, PwC knew that the Funds's investments were highly concentrated with Madoff and that the existence of these assets should have been corroborated with competent audit evidence. (SCAC ¶¶292, 295, 297-99.)

The applicable auditing standards specifically provide that confirmations from service organizations such as Madoff's are not acceptable audit evidence. (SCAC ¶300 citing AU §332.16.) Moreover, where, as here, a service provider (one wholly-owned and controlled by a single, secretive person, no less) is serving in multiple capacities as investment manager and the custodian of the Funds' assets with no independent checks, the auditing standards require that the

[10] The SEC in its Complaint dated March 18, 2009 against David Friehling and F&H (S.D.N.Y. 09 CV 2467) stated that "one of the fundamental audit tests performed on a broker-dealer is to ascertain that

auditor perform additional procedures, including site visits to inspect documentation and identification of controls by the service organization. (*Id*. ¶301 and AU §332.20.)

Independent verification of the Funds' assets should have obtained as a matter of course. PwC knew that Madoff's supposed *modus operandi* was to convert all the assets of the Funds into treasury bills at the end of each calendar year, purportedly to conceal his investment strategy from competitors (SCAC ¶¶223, 308). For example, 97.3% of the Fairfield Sentry holdings were said to be invested in treasury bills as of year-end 2007 (PwC Financial Report for the Fairfield Sentry Funds dated April 7, 2008, Duffy Decl. Exh. 1[11]). The corresponding figure for year-end 2006 was 95.6%. Madoff even gave PwC the name of the bank that supposedly held government securities for BMIS and disclosed that the trades were cleared by the Government Securities Clearing Corporation (the "GSCC") (PwC Report). A single confirmation letter or phone call to these institutions would have disclosed the non-existence of the claimed assets.

The Audit Plan further required PwC obtain an understanding of the internal controls at Madoff's operation and to perform transaction testing on its investment strategy. (SCAC ¶¶307-308.) Moreover, the facts that Madoff purportedly initiated and executed the split-strike conversion trading strategy, had custody of the securities, and prepared trading and account information, increased the risk of misappropriation of the assets and of material misstatements at the financial statements level. *Id*. ¶¶300-301. PwC was obligated, *inter alia*, to design further audit procedures in response to those audit risks. (*Id*. ¶¶ 295, 297, 300-303, 306, 310-311.) It was also required to test the split-strike conversion strategy. *(Id*. ¶¶272-273, 306-310.).

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securities held by the broker-dealer do, in fact, exist." This statement applies equally to PwC in its audit of the Funds. A copy of this SEC Complaint is appended to the Vickery Decl. as Exh. 9.

[11] The Duffy Affidavit dated December 22, 2009 ("Duffy Decl.") and the exhibits thereto were submitted in support of the PwC Canada's motion to dismiss.

Nevertheless, PwC failed to perform any procedures to audit the occurrence of the transactions involved in the split-strike conversion (*id*. ¶¶306, 308-310, 315), including obtaining confirmation from counterparties or settling parties, confirming the pricing on the securities, or performing physical inspection of the securities. (*Id*. ¶¶272, 306-310, 315.)

PwC's recklessness included accepting at face value the audit reports of Madoff's operations even though the reports were certified by an accounting firm that on its face was unqualified to conduct an audit of a multi-billion dollar broker-dealer operation. It was a matter of public record, and PwC knew, that Madoff was audited by Friehling & Horowitz ("F&H"), an obscure accounting firm which operated out of a storefront in Rockland County, New York (SCAC ¶222). A letter from PwC Netherlands to Fairfield Greenwich Group, dated March 15, 2005 (the "PwC Letter," Vickery Decl., Exh.8) states that PwC had received a copy of a standard letter of internal control issued by BMIS'S auditors, F&H. F&H had only three employees, a retired partner living in Florida, a secretary, and one active CPA (*id*.). According to PwC's own Guide, if an auditor is unfamiliar with or has questions surrounding the professional reputation and standing of an investee fund's auditor, it should obtain additional audit evidence (PwC Guide at 28; SCAC ¶295 citing the AICPA "Audit & Accounting Guide – Investment Companies at §5.64) (A copy of this AICPA publication is appended to the Vickery Decl. as Exh. 10). At a minimum, PwC was required to investigate the professional reputation and standing of F&H and to discuss with F&H the results of BMIS's most recent audit. (SCAC ¶302.) It failed to do either, ignoring auditing standards, its own Guide, and yet another red flag.

ARGUMENT

I. THE SCAC STATES SECTION 10(B) AND RULE 10(B)(5) CLAIMS AGAINST PWC CANADA AND PWC NETHERLANDS

PwC Canada and PwC Netherlands attack the sufficiency of the SCAC's *scienter*, reliance and loss causation allegations in support of the claims under §10(b).

A. The SCAC Adequately Pleads *Scienter*

Under the PRIVATE SECURITIES LITIGATION REFORM ACT ("PSLRA"), a complaint alleging violations of §10(b) of the Exchange Act must state "facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. §78u-4(b)(2). *Scienter* is sufficiently pled where the inference of fraud is "at least as compelling as" any non-culpable justification for a defendant's alleged conduct. *Tellabs, Inc. v. Makor Issues & Rights, Ltd*, 551 U.S. 308, 324 (2007). Moreover, "[the] inference that the defendant acted with scienter need not be irrefutable, *i.e.*, of the 'smoking-gun' genre, or even the 'most plausible of competing inferences.'" *Id.* (citation omitted).

Circumstantial evidence supporting a "strong inference" of *scienter* can be demonstrated by facts showing "conduct which is highly unreasonable" and which represents "an extreme departure from the standards of ordinary care to the extent that the danger was either known to the defendant or was so obvious that the defendant must have been aware of it." *Rothman v. Gregor*, 220 F.3d 81, 90 (2d Cir. 2000) (citation omitted). A plaintiff meets this standard by alleging that the defendant "knew facts or had access to information suggesting that their public statements were not accurate" or "failed to check information they had a duty to monitor." *Novak v. Kasaks*, 216 F.3d 300, 311 (2d Cir. 2000).

"[A]llegations of a recklessly performed audit will approximate intent." *Varghese v. China Shenghuo Pharmaceutical Holdings, Inc.*, 2009 WL 4668579, at *10, (S.D.N.Y. Dec. 9, 2009). This Court recently reaffirmed that a plaintiff sufficiently pleads such intent by alleging facts demonstrating that:

> the accounting practices were so deficient that the audit amounted to no audit at all, or an egregious refusal to see the obvious, or to investigate the doubtful, or that the accounting judgments which were made were such that no reasonable accountant would have made the same decisions if confronted with the same facts.

Id. at 9; s*ee also In re IMAX Secs. Litig.*, 587 F. Supp. 2d 471, 483 (S.D.N.Y. 2008) (denying motion to dismiss based on PricewaterhouseCoopers' alleged reckless conduct). The Court in *Varghese* could have been speaking about PwC's actions here. The SCAC's allegations as to PwC Canada and PwC Netherlands meet these standards. *See* SCAC ¶¶259-318, 460-468.

1. The SCAC Alleges Facts Giving Rise to a Strong Inference of *Scienter*

The SCAC sets forth in extensive detail the reckless manner in which PwC conducted the audits of the Funds. (SCAC ¶¶ 154-155, 261-267, 272-273, 291-293, 295-297 300-302, 305-308, 310-311, 314-315, 466-467; s*ee also* PwC Report at 4 (cited at SCAC ¶¶ 272-273)). In addition to failing to follow what its own documents recognized as the most basic and critical auditing procedures, PwC failed to investigate the doubtful information provided evidenced by its ignoring the significant "red flags" indicating fraud. *Id.* ¶¶221-223, 271, 272, 274, 300, 307-308, 316; PwC Report at 7. An auditor's accounting violations and disregard of red flags is sufficient to establish *scienter*. *Varghese,* 2009 WL 4668579, at *10.

PwC Canada and PwC Netherlands recklessly disregarded and ignored numerous significant "red flags" that "would [have] place[d] a reasonable auditor on notice" that the Funds' financials did not accurately represent the condition of the Funds. *See In re IMAX Sec. Litig.*, 587 F. Supp. 2d at 483-84. For example:

- All of the Funds' assets were managed by Madoff, who acted as investment advisor, broker-dealer, and custodian of those assets – a highly unusual arrangement with no checks and balances. SCAC ¶¶ 221, 300, 307, 316; PwC Letter p.5 (cited at ¶271). This arrangement was particularly alarming in view of Madoff's secretive operations, in which many of the key positions were held by his family members. (SCAC ¶¶ 218, 220.)

- Madoff told representatives of PwC that all options were traded over-the-counter and that he used various counterparties. However, Madoff refused to identify any of the counterparties. PwC Report at 7.

- All assets in the Funds were held in government securities at the end of each quarter and each year, for almost a decade. SCAC ¶¶ 223, 308.[12]

- Madoff told PwC Defendants' representatives that "99% of all trades are electronic" but PwC knew Madoff did not provide electronic confirmations to the Funds and gave them delayed, easy-to-forge paper confirmations of trades. *Id*. ¶¶ 223, 272.

- PwC member firms *alone* were auditing, through the audits of nine feeder funds, almost the total amount of BMIS's SEC reported assets under management, approximately $17 billion. *Id*. ¶¶ 271, 274.

- BMIS, an organization which theoretically managed well over ten billion dollars, was not audited by a "qualified reputable independent audit firm" but by a three-employee storefront operation. *Id*. ¶¶ 222, 314.

- The Funds had no internal controls with respect to the investments in Madoff, and their management conducted no due diligence of Madoff and had no clue as to how Madoff's purported investment strategy actually worked. *Id*. ¶ 314.

- Madoff purported to turn consistent investment returns during good times and bad times in the market. *Id*. ¶ 223.

Some of these "red flags" were known to PwC as a result of rare, albeit superficial and ineffectual interviews and visits with Madoff, *See e.g.*, SCAC ¶¶ 271-272, and from monitoring press reports for significant developments regarding its clients. And although PwC's own Audit Plan identified some of them as representing audit risks which required additional auditing

[12] *See e.g.*, Fairfield Sentry Directors Report and Financial Statements for the Years Ended December 31, 2007 and 2006 (Duffy Decl. at Exh. I); Fairfield Sigma Financial Statements for the Years Ended December 31, 2007 and 2006 (*id*. at Exh. J); Greenwich Sentry Financial Statements for the Years Ended December 31, 2007 and 2006 (*id*. at Exh. K).

procedures and testing, *see e.g.*, ¶¶ 287-288; PwC Audit Plan p. 11 (cited at ¶276 *et seq.*), PwC ignored them when conducting its audits.

For example, PwC did not place a ***single telephone call or send a single confirmation letter to a counter-party***. Nor did PwC ever make a ***single request to physically examine*** or obtain competent audit evidence of the billions of dollars in securities representing the investments in Madoff, despite the PwC Guide recognizing that "it [is] necessary for the auditor to request confirmation of the fund's holdings on a security-by-security basis." SCAC ¶292 (quoting PwC Guide at 3). Instead, in its infrequent (and unproductive) meetings with Madoff, PwC accepted Madoff's representations at face value and did not perform any independent confirmation or analysis of his purported trades for the benefit of the Funds, ignoring his refusal to answer even basic questions about his operation and his unchecked control over all facets of the investments. (*Id*. ¶¶ 272-3).

By willfully ignoring red flags and refusing to investigate the doubtful, PwC disregarded fundamental auditing standards. (SCAC ¶¶ 283-286, 289-292; AU §§150.2, 230.08, 316; ISA 200.15, 200.16, 240.) Moreover, PwC recklessly violated auditing standards by failing to: (1) assess Madoff and/or BMIS's significance to the Funds and to obtain a sufficient understanding of BMIS and its internal controls, in order to assess risks of material misstatements in the Funds' financial statements; (2) obtain audit evidence of Madoff's representations that the vast majority of the Funds' assets were in Treasury Bills; (3) obtain external confirmation of the existence of the Treasury Bills from the bank custodian or GSCC; (4) perform transaction testing on Madoff's investment strategy; (5) perform substantive tests to confirm the existence of Madoff's options transactions, Madoff's counterparties, or whether there were outstanding derivative contracts that negated the ownership of the Treasury Bills; (6) test the accuracy of the Net Asset Value

("NAV"); and (7) critically assess BMIS's auditor and its supposed audit of BMIS. SCAC ¶¶ 272-273, 291-293, 295-297 300-302, 305-311, 314-315, 466-467; PwC Report at 4.

Allegations of such reckless auditing satisfy the pleading requirements for *scienter*. *See Varghese*, 2009 WL 4668579, at *10 (where auditor "committed GAAS and GAAP violations and disregarded red flags," "Plaintiffs' allegations raise a strong inference of scienter"); *In re IMAX Sec. Litig.*, 587 F. Supp. 2d at 485 (allegations that PwC "was reckless" in not detecting the alleged violations were "strong enough"); *In re Winstar Commc'ns*, 2006 WL 473885, at *11 (S.D.N.Y. Feb. 27, 2006)("An auditor's reckless disregard of red flags, coupled with allegations of GAAP and GAAS violations, is sufficient to support a strong inference of scienter."); *Whalen v. Hibernia Foods PLC*, 2005 WL 1799370, at *3 (S.D.N.Y. Aug. 1, 2005) ("Plaintiffs allege… [PricewaterhouseCoopers] knew about and ignored a wide variety of 'red flag' incidents or events that should have put [it] on notice that fraud was afoot, and that taken together they are sufficient for the Court to find a strong inference of recklessness"); s*ee also In re New Century*, 588 F. Supp. 2d 1206, 1234-1235 (C.D. Cal. 2008) (KPMG's audit team's failure to consider "red flags" raised by KPMG's internal specialist was sufficient to find a strong inference of *scienter*). PwC's claim that that the SCAC does not support an inference of *scienter* (*PwC Netherlands Brf.* at 11-14; *PwC Canada Brf.* at 8-9) has no merit.

The two main cases on which PwC relies, *In re Bayou Hedge Fund Litig.*, 534 F. Supp. 2d 405 (S.D.N.Y. 2007), *aff'd, South Cherry St., LLC v. Hennessee Group LLC*, 573 F.3d 98 (2d Cir. 2009) ("*South Cherry*"), and *In re Doral Financial Corp. Sec. Litig.*, 563 F. Supp. 2d 461, 466 (S.D.N.Y. 2008), *aff'd, West Va. Invst. Mgmnt. Bd. v. Doral Fin. Corp.*, 2009 WL 2779119

(2d Cir. Sept. 3, 2009) ("*Doral*"), are readily distinguishable.[13] *South Cherry* is inapposite for two fundamental reasons. First, *South Cherry* did not involve an auditor subject to comprehensive professional guidelines and standards. Rather, it involved a non-fiduciary investment advisor. *South Cherry*, 573 F.3d at 115. Here, GAAS and ISA provided clear benchmarks which PwC Canada and PwC Netherlands recklessly violated, as the SCAC alleges. *See e.g.*, SCAC ¶¶ 284-286, 289-291, 297-301, 305. Second, and most significantly, the plaintiff did not allege "any fact that supposedly should have put [the defendant consultant] on fraud alert." 573 F.3d 113. The only red flag alleged in the complaint was that the funds' auditor was named "Richmond Fairfield," an allegation that the Second Circuit found to be inconsequential. In contrast, as discussed above, the SCAC alleges multiple red flags, including blatant inconsistencies, which should have alerted PwC that Madoff's operation was suspect and that heightened audit scrutiny was mandatory. SCAC ¶¶ 221-223, 271, 272, 274, 300, 307-308, 316; PwC Report at 7.

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[13] The other cases PwC cites involved mere negligent accounting practices and other circumstances not rising to recklessness and disregard, but nevertheless acknowledge that recklessness in the context of an audit, as alleged here, can constitute *scienter*. *See, e.g., ECA and Local 134 IBEW Joint Pension Trust of Chicago v. J.P. Morgan Chase Co.*, 553 F.3d 187, 202 (2d Cir. 2009)(recklessness could not be inferred where allegedly disregarded "related-party transactions" were not "material"); *Rothman*, 220 F.3d 98 (auditor did not recklessly disregard product sales data based on its role as outside auditor); *In re Carter-Wallace Inc. Sec. Litig.*, 220 F.3d 26, 40 (2d Cir. 2000) (reckless disregard of reports could not be inferred from reports which "did not demonstrate a statistically significant link"); *Decker v. Massey-Ferguson, Ltd.*, 681 F.2d 111, 120-21 (2d Cir. 1982) (failure to identify internal control problems and accounting practices insufficient); *Stevelman v. Alias Research Inc.*, 174 F.3d 79, 85 (2d Cir. 1999) (corporation's business projections did not indicate *scienter*); *Shields v. Citytrust Bancorp. Inc.*, 25 F.3d 1124, 1129 (2d Cir. 1994) (recklessness not shown based on future business prospects); *In re CBI Holding Co, Inc.*, 2009 WL 4642005, at *9 (S.D.N.Y. Dec. 4, 2009) (auditor conducted "sufficient vendor reconciliations" and made other "efforts to follow up"); *In re Scottish Re Group Sec. Litig.*, 524 F. Sup.2d 370, 398 (S.D.N.Y. 2007) (auditor's conduct only "would support a claim of negligence"); *Sloane Overseas Fund, Ltd. v. Sapiens Int'l Corp.*, 941 F. Supp. 1369, 1382 (S.D.N.Y. 1996) (holding that only accounting violations were alleged); *In re Dell Inc., Sec. Litig*, 591 F. Supp. 2d 877, 903 (W.D. Tex. 2008) (plaintiffs allege "no facts about [PricewaterhouseCoopers'] audit, what it entailed, or how it was deficient").

In *Doral*, the alleged financial improprieties were a "tightly-held secret" of "only a few managers" that could not readily be discovered by PwC. 2009 WL 2779119, at *2. A former Doral director allegedly induced a Morgan Stanley employee to approve the valuations at issue and thereby falsified "independent" data on which PwC "could properly have relied." 563 F. Supp. 2d at 465-66. Here, the SCAC makes abundantly clear that that PwC improperly relied upon Madoff for confirmations, even though it was obligated by the accounting standards to seek independent confirmation of transactions and assets and blatantly ignored red flags. A request for confirmation to any of BMIS's purported counterparties or independent custodians, a cornerstone of properly conducted audits, would have exposed the falsity of the Funds' financial statements. The conduct in *Doral* and in this case are worlds apart.[14]

2. No Plausible Competing Inference Exists

Under *Tellabs*, "[a] complaint will survive . . . if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged." 551 U.S. at 324. Thus, where two equally compelling inferences can be drawn, one demonstrating *scienter* and the other supporting a non-culpable explanation, *Tellabs* instructs that the complaint should be permitted to move forward. *Id. See also ACA Fin. Guar. Corp. v. Advest, Inc*., 512 F.3d 46, 59 (1st Cir. 2008).

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[14] PwC's cases involve non-significant accounting violations and "complex" auditing assessments. *See In re Marsh & McLennan Cos. Sec. Litig.*, 501 F. Supp. 2d 452, 477-478 (S.D.N.Y. 2006) (holding that no violations of GAAP or accounting fraud occurred and payments were adequately "recognized and reported"); *In re Priceline.com Inc.*, 342 F. Supp. 2d 33, 57-58 (D. Conn. 2004) (holding that the assessment the auditor should have allegedly reached "is far too complex for the court to conclude that Deloitte's failure to do so rendered its audit a farce"); *Nappier v. PricewaterhouseCoopers LLP*, 227 F. Supp. 2d 263, 278 (D.N.J. 2002) (client's change of sales policy did not give reason for policy change, could not support recklessness, and was not found in auditor's files); *Dell*, 591 F. Supp. 2d at 902 (scienter was not properly alleged because the plaintiffs there "d[id] not identify any specific records or information [PricewaterhouseCoopers] failed to obtain or inspect which would have alerted them to the alleged fraud at Dell if they had inspected it.").

Here, the inference of *scienter* is at least as compelling (and in fact more so) as any other inference offered by PwC Canada and PwC Netherlands. PwC Canada baldly asserts that "whatever inference plaintiffs have created is nowhere near as compelling as the opposing inference: that PwC Canada did not act fraudulently or recklessly." *PwC Canada Brf.* at 9. PwC Netherlands argues that the "far more compelling" inference is that it "did not discover or participate in Madoff's fraud" and that "its obvious self-interest" prohibited doing so. *PwC Netherlands Brf.* at 14-15. Those assertions, of course, beg the question of why PwC blatantly ignored its own audit guidelines, the accepted auditing standards, and the red flags to which it was privy. Essentially, PwC argues that because others did not uncover Madoff's fraud, it cannot be held responsible for its audit failures. That misses the mark because Plaintiffs did *not* allege *scienter* because PwC either participated in or failed to uncover the Madoff fraud. Rather, they allege *scienter* on the basis of PwC's severely reckless conduct in performing the Funds' audits its willful blindness of significant red flags.[15] *See, e.g.*, *Rothman v. Gregor*, 220 F.3d at 90. The SCAC's allegations that PwC Canada and PwC Netherlands conducted their audits of the Funds and certified their financial statements recklessly, or with *scienter* are certainly "at least as compelling as any opposing inference one could draw from the facts alleged." *Tellabs*, 551 U.S. at 324.

[15] Nor can PwC shield itself by relying upon what the SEC did or did not do or arguing that its self-interest precludes the alleged conduct. *See PwC Netherlands Brf.* at 14-15. The SEC is an agency with limited resources, and an auditor may be liable regardless of that agency's conduct. In fact, in *Varghese*, this Court recently denied the auditor's motion to dismiss even though the SEC also failed to detect the accounting fraud at issue in that case. PwC Netherlands' assertion that its "obvious self-interest" is not to collude or collaborate with a fraud may be discounted completely — this argument applies equally to *all participants* in any securities fraud.

B. The SCAC Adequately Pleads Reliance

Reliance requires a showing that "but for the claimed misrepresentations or omissions, the plaintiff would not have entered into the detrimental securities transaction." *Varghese*, 2009 WL 4668579, at *5 (citation omitted). On a motion to dismiss, plaintiffs need only allege that but for the misstatements they would not have purchased the securities.[16] *Id.* at *8. As in *Varghese*, Plaintiffs allege that the audit opinions "induced Plaintiffs to make additional investments in the Funds" (SCAC ¶462; see also ¶ 468 ("Plaintiffs relied, to their detriment, on such misleading statements and omissions contained in PwC Canada's and PwC Netherlands' clean audit opinions by investing additional monies in the Funds.")).

Indeed, PwC seems to conflate the pleading requirements with the method of common proof, an issue best reserved for class certification. PwC thus suggests that in the absence of the fraud-on-the-market presumption of reliance, Plaintiffs must each individually *allege* reliance on specific statements; but the law does not require such pleading. *See Cromer Finance*, 2001 WL 1112548, at *1-*2 (S.D.N.Y. Sept. 19, 2001) (rejecting this same argument and finding plaintiffs' reliance allegations, similar to those of the SCAC, sufficient). [17]

In any event, the absence of the fraud-on-the-market presumption does not preclude common proof of reliance on the audit reports issued to the Funds' shareholders. *See Cromer Finance Ltd. v. Berger*, 205 F.R.D. 113 (S.D.N.Y. 2001) ("*Cromer II*"). In *Cromer II*, the

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[16] PwC also asserts that "those plaintiffs who cannot allege that they actually purchased or redeemed their interests in the Funds in reliance on PwC Canada's 2006 and 2007 audit report have no standing to bring a 10(b) claim." *PwC Canada Brf.* at 11. The SCAC sufficiently alleges reliance on the audit reports. ¶¶ 275, 279, 462, 468. Nowhere does the SCAC allege a violation of §10(b) claiming that Plaintiffs relied on the audit reports to retain their shares or limited partnership interests; rather, Plaintiffs allege those audit reports induced them to invest additional money into the Funds. ¶ 468.

[17] PwC cites to *In re NationsMart Corp. Sec. Litig.*, 130 F.3d 309 (8th Cir. 1998), *cert. denied*, 524 U.S. 927 (1998), to impose a Rule 9(b) requirement on the reliance element of a §10(b) claim. The courts of the Second Circuit have not adopted the *NationsMart* view.

investors in a private investment fund, like Plaintiffs here, filed a §10(b) claim against the fund's auditor, which had conducted "annual audits [and] certified the year-end" financial statements, after it was revealed that the fund manager had "manufactured false statements showing the Fund to be profitable" for five years. *Id.* at 118. The *Cromer II* court recognized that even in the absence of the fraud-on-the-market presumption, a similar presumption of reliance would apply concerning the calculations of the NAV of the funds audited and/or confirmed by the funds' auditors. *Id*. at 130-131. In applying that presumption, the *Cromer II* court considered that "[p]rior to investing in the Fund, each investor received a copy of the Offer Memo, which listed Ernst & Young as the Fund administrator and Deloitte as the Fund auditor, and described the method for calculating the NAV," *id*. at 130, and concluded that "investors were entitled to presume that the NAVs had in fact been calculated as described in the Offer Memo, and that Deloitte had in fact performed an audit in accordance with applicable professional standards…." *Id*. at 131. The court concluded by reiterating the common sense approach that

> "Courts presume reliance 'where it is logical to presume that reliance in fact existed.' It is difficult to imagine an investor putting money into any fund without relying on the integrity of the process for calculating the fund's NAV, as supported by auditor review... fairness, judicial economy, common sense and probability all support adoption of a rebuttable presumption that investors in the Fund relied in their investment decisions on the integrity of the NAVs calculated, issued and confirmed by [Ernst & Young and Deloitte]."

Id. It is no different here. *See* SCAC ¶¶ 279, 304, 335; *see also* 2003 Fairfield Sentry Private Placement Memorandum ("PPM") cover page (identifying the price per share of the Fund as well as the Fund's NAV); 2003 Fairfield Sentry PPM at vi (identifying PwC Netherlands as the Fund's auditor and Citco Fund Services as the Fund's administrator), and at 12-13 (defining

calculation of NAV); 2003 Fairfield Sentry PPM Subscription Agreement at 5 (acknowledging receipt of PPM).[18]

PwC's cases do not compel a contrary conclusion. In *Feinman v. Dean Witter Reynolds, Inc.*, 84 F.3d 539, 541 (2d Cir. 1996), the court held that "appellants did not attempt to plead that the mislabeling of the fees 'induced [them] to enter into the transactions." In *Sable v. Southmark/Envicon Capital Corp.*, 819 F. Supp. 324, 338-339 (S.D.N.Y. 1993), the court found an absence of reliance where the documents at issue specifically contradicted any basis for reasonable reliance. Here, the SCAC alleges at ¶462: "These statements [*i.e.*, the audit opinions] induced Plaintiffs to make additional investments in the Funds." Also, PwC addressed the audit reports to the Funds' shareholders and partners (SCAC ¶275), in recognition that the audit reports would "provide assurance on financial information released by the Funds." *Id*. ¶277.

C. The SCAC Adequately Pleads Loss Causation

As this Court has explained: "[l]oss causation requires a link between the alleged misconduct and the ultimate economic harm suffered by the plaintiff, and a plaintiff must claim that 'the loss be foreseeable *and* that the loss be caused by the materialization of the concealed risk.'" *Varghese*, 2009 WL 4668579, at *5. PwC's failure to conduct appropriate audits and issuance of clean audit opinions on the Funds' financial statements (SCAC ¶¶261-267) necessarily led to Plaintiffs' investment in the Funds, resulting in losses. *See e.g.*, *In re Parmalat Sec. Litig.*, 375 F. Supp. 2d 278, 306-308 (S.D.N.Y. 2005); *Cromer Finance Ltd.*, 2003 WL 21436164 (S.D.N.Y. June 23, 2003) (court rejected accounting firm's argument that fund losses were caused by fraudulent NAV's calculated by administrator and fund's short-selling strategy, finding instead that loss causation element was satisfied where the fund audits contained material

[18] A copy of the 2003 Fairfield Sentry PPM is appended as Exh. 11 to the Vickery Decl.

misrepresentations of fact, and the losses suffered by plaintiffs were a foreseeable consequence of the inaccuracies). Ignoring this fact, PwC asserts that the losses "were in ***no sense*** 'caused' by PwC Canada; they were caused by Madoff." *PwC Canada Brf.* at 11 (emphasis added). Of course, PwC Canada and PwC Netherlands ignore that had they performed audits comporting with the relevant audit standards, they could not have issued unqualified audit reports because the Funds' assets did not exist. SCAC ¶313. *See United States v. Arthur Young & Co.*, 465 U.S. 805, 819 n.14 (1984), ("The inclusion in an audited financial statement of anything less than an unqualified opinion could send signals to stockholders, creditors, potential investors, and others that the independent auditor has been unable to give the corporation an unqualified bill of financial health. Such a public auditor's opinion could well have serious consequences for the corporation and its shareholders.").

Accordingly, PwC's false audit reports concealed the risk that the Funds' assets did not exist, that the investment strategy disclosed in the notes to the financial statements did not have a basis in fact, and that the NAV calculations were inaccurate. In fact, these concealed risks *did* materialize, resulting in Plaintiffs' losses. *See Parmalat*, 375 F. Supp. 2d at 307. Plaintiffs do not argue, as PwC misleadingly suggests, that "had PwC Canada ***exposed*** Madoff's fraud, plaintiffs would not have lost their money." *PwC Canada Brf.* at 11 (emphasis added). Rather, the relevant issue is had PwC conducted proper audits, it could not have issued unqualified audit opinions on the Funds' financial statements, an event which would have caused Plaintiffs both not to invest and to immediately seek redemption of their existing investment—whether or not the auditors exposed Madoff's fraud. PwC's argument boils down to the incredible assertion that its issuance of clean, but erroneous, opinions had nothing to do with Plaintiffs' losses. That argument flies in the face of PwC's recognized duty to "assure" Plaintiffs as to the accuracy of

the Funds' financial statements, as alleged in the SCAC (*see e.g.*, SCAC ¶ 276; Audit Plan at 8).[19]

D. Plaintiffs' Federal Securities Law Claims against PwC Netherlands Based On its 2002 Audit Report Are Not Time-Barred

PwC Netherlands challenges only the timeliness of Plaintiffs' securities law claims based on its 2002 audit reports, asserting that they are barred by the §10(b) five-year statute of repose. Those claims are not time-barred because PwC Netherlands repeated misrepresentations (*e.g.*, its compliance with GAAS and the accuracy of the Funds' financial statements) from its 2002 audit report in later audit reports, and the repose period regarding a series of related misrepresentations starts only on the date of the last alleged misrepresentation. *See* Plaintiffs' Consolidated Response to the Citco Defendants' Motion to Dismiss at § VII, which is incorporated by reference herein. [20]

Additionally, the statute of repose begins on "the date the plaintiff, in reliance on the misrepresentation, purchases or sells the security in question." *In re Gilat Satellite Networks, Ltd.*, 2005 WL 2277476, at *22 (E.D.N.Y. Sept. 19, 2005); *see also Shalam v. KPMG, LLP*, 2005 WL 2139928, at *2 (S.D.N.Y. Sept. 6, 2005). Here, there is an issue of fact regarding when any Plaintiff purchased Fund interests in reliance on the 2002 audit reports that precludes dismissal of Plaintiffs' claims. The PwC 2002 audit report for the Sentry Fund is dated May 27, 2003 and was the most recent audit report for the fund until the 2003 audit report was released on

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[19] Whether an intervening event (such as another actor's fraud) cuts off the causation link must await later resolution, as one of PwC's authorities (*PwC Canada Brf.* at 11) recognizes. *See Emergent Capital Inv. Mgmt., LLC v. Stonepath Group, Inc.*, 343 F.3d 189, 197 (2d Cir. 2003) (proof of intervening event severing the causal link is "a matter of proof at trial and not to be decided on a Rule 12(b)(6) motion to dismiss.").

[20] For the purpose of establishing the repose period, Plaintiffs accept *arguendo* PwC Netherlands' contention that the bar date is measured from April 23, 2009, the date when the first complaint naming PwC as a defendant was filed. *PwC Netherlands Brf.* at 24, fn. 14.

or after June 29, 2004. Some members of the class, undoubtedly, purchased shares in Sentry in reliance on the 2002 audit report after the assumed April 23, 2004 cut-off date. The statute of repose does not bar Plaintiffs' §10(b) claims for purchases of Fund interests made after April 23, 2004 in reliance on PwC's 2002 audit reports.

II. THE SCAC PLEADS VIABLE STATE LAW CLAIMS AGAINST PWC CANADA AND PWC NETHERLANDS

A. Plaintiffs' State Claims Are Governed by the Notice Pleading Standards of Fed. R. Civ. Pro. Rule 8(a) and Not Rule 9(b)

PwC Netherlands makes the specious argument that by alleging fraud in the SCAC's allegations of fact section in connection with Plaintiffs' §10(b) claims (*see, e.g.*, ¶260) and later realleging all foregoing paragraphs in each count of the SCAC, Plaintiffs' non-fraud state law claims are subject to the pleading requirements of Rule 9(b) (*PwC Netherlands Brf.* at 16).

Contrary to that assertion, Rule 8(a) applies to Plaintiffs' negligence, gross negligence, negligent misrepresentation,[21] third-party beneficiary breach-of-contract, and aiding and abetting breach of fiduciary claims[22] (collectively, "non-fraud state claims") because those claims are not grounded in fraud. *Rombach v. Chang*, 355 F.3d 164 (2d Cir. 2004) (*PwC Netherlands Brf.* at 16), does not hold otherwise. *Rombach* narrowly decided that Rule 9(b) applies to claims brought under §§ 11 and 12(a)(2) if they are based on allegations of fraud. 355 F.3d at 167, 170-71. Plaintiffs' non-fraud state claims, however, do not sound in fraud. Those claims are based

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[21] District courts have applied Rule 9(b) to negligent misrepresentation claims only where the factual predicates "sounded in fraud" by incorporating fraud-based allegations, *see, e.g., In re Parmalat Sec. Litig.*, 479 F. Supp. 2d 332, 340 n.30 (S.D.N.Y. 2007), or being worded in fraud terms, *see, e.g.*, *Deblasio v. Merrill Lynch & Co.*, 2009 WL 2242605, (S.D.N.Y. 2009). Notably, to ground a claim in fraud, it is insufficient merely to use the word "misrepresented." *In re Agria Corp. Sec. Litig.*, 2009 WL 4276967 (S.D.N.Y. 2009).

[22] Plaintiffs concede that the aiding and abetting fraud claim must be pleaded under Rule 9(b). As discussed below, plaintiffs sufficiently allege that claim under the heightened pleading requirement. *See* Section IID, infra.

on PwC's reckless failure to properly conduct its audits (SCAC ¶¶ 430, 437, 441, 449, 453)—a claim clearly sounding in negligence—and not on any intentional fraudulent conduct. Thus, Rule 9(b) does not apply, and Plaintiffs' non-fraud state claims are governed instead by Rule 8(a).[23]

B. The SCAC States a Claim for Negligent Misrepresentation against PwC Canada and PwC Netherlands

1. Plaintiffs Had a Relationship Approaching Privity With PwC.

PwC Canada's and PwC Netherlands' motions to dismiss avoid the critical question: if an accounting firm undertakes to audit an investment fund and issues to the fund's limited partners and shareholders an independent opinion expressly for the purpose of providing them with "assurance" about the accuracy of the fund's financial statements, for whom, if not those persons, is the audit opinion intended? PwC's incredible assertion that Plaintiffs' negligence claim fails because Plaintiffs did not have "a relationship approaching privity" (*PwC Canada Brf.* at 19; *PwC Netherlands Brf.* at 6) with PwC flies in the face of the allegations of the SCAC, all of which are deemed true for purposes of this motion and many of which are grounded upon PwC's own documents attached to the SCAC, including PwC's Audit Plan and auditor's letters.

PwC misrepresented both that it would conduct audits in accordance with accepted auditing standards and, as a result of its reckless failure to do so, misrepresented that the Funds financials it audited "fairly represented" the true condition of the Funds. As detailed in the SCAC, PwC failed to conduct the represented audit; and it is beyond dispute that the Funds' financials did not in any sense fairly represent the true condition of the Funds. Contrary to PwC's attempt to distance itself from Plaintiffs, the SCAC clearly sets forth PwC's direct

[23] However, in the event that the Court finds Plaintiffs' non-fraud state claims subject to Rule 9(b), Plaintiffs ask that the Court judge those claims without incorporating prior fraud allegations or that the

responsibility to Plaintiffs and, importantly, PwC's own understanding and acceptance of that responsibility. As alleged in the SCAC, PwC directed every audit report at issue to "the directors and shareholders of" the Funds, *i.e.* the Plaintiffs. (SCAC ¶275.) PwC did so because it expressly recognized that it was "responsible for reporting to the … shareholders and/or partners on the financial statements of the Funds." (*Id*. ¶276, quoting from PwC's Audit Plan at 8.) PwC further acknowledged that one purpose of its "audit engagement" was to provide "shareholders and other stakeholders" in the Funds "independent opinions and reports that *provide assurance on financial information released by the funds*." (Audit Plan at 8; emphasis supplied.)

In the seminal case of *Credit Alliance Corp. v. Arthur Andersen & Co.*, 493 N.Y.S. 2d 435 (N.Y. Ct. App. 1985), the court held that an auditor's liability is not limited to those who contract with the auditor; rather, an auditor also owes a duty of care to those who, although not in contractual privity, have a relationship with the auditor "sufficiently approaching privity." *Id.* at 553. In crafting the reach of this duty to non-contracting parties, the Court of Appeals relied on Judge Cardozo's opinion in *Glanzer v. Shepard*, 233 N.Y. 236 (N.Y. Ct. App. 1922), which recognized a duty by a provider of information to a party not in contract when that non-contracting party's use of the information "was not an indirect or collateral consequence of the action…but a consequence which, to [the provider of the information's] knowledge, was the end and aim of the transaction…." 493 N.Y.S. 2d at 441 (emphasis in original).

In order to satisfy this near-privity requirement, the *Credit Alliance* court held that a plaintiff must plead and prove that:

> (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

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Court grant Plaintiffs leave to amend the SCAC to correct any pleading deficiencies the Court identifies.

> accountants linking them to that party or parties, which evinces the accountants' understanding of that party or parties' reliance.

Id. at 443. PwC's ***own view*** of its audit engagement unequivocally establishes that *Credit Alliance* is met here, because it makes clear that providing Plaintiffs "assurance" with respect to the accuracy of the audited financial information was not "an indirect or collateral consequence," but rather the "end and aim" of its assignment to audit the Funds. *See* Audit Plan at 8. As discussed in detail below, Plaintiffs have thus pled and satisfied each of the *Credit Alliance* requirements (*see, e.g.*, SCAC ¶¶ 435, 436) and alleged that PwC was in near privity with Plaintiffs.

2. PwC Knew that its Audits Were to Be Used for a Particular Purpose.

The Funds are either Delaware limited partnerships or International Business Companies organized under BVI law with a limited number of partners and shareholders. (SCAC ¶¶ 170-173.) Participation in the Funds was restricted to "professional investors" with a minimum net worth of at least $1 million for individual and $5 million for institutions (Fairfield Sentry PPM 8.14.06 (Thorne Decl. at Exh. 1)). The minimum investment in the Fund was $100,000. (*Id.* at 1.)

PwC knew that the Funds were not in any sense "operating" businesses. PwC knew, rather, that the vast majority of the Funds' assets were to be invested by Madoff. (SCAC ¶ 279.) Put another way, PwC knew that investors' interest in the Funds was, in reality, primarily an interest in how their investments with Madoff were performing.[24] (*Id*.) For that reason, as PwC recognized in its Audit Plan, PwC undertook a duty, when auditing the financial statements of

[24] The Audited Financial Statements state that the Funds have no employees. *See, e.g.*, Fairfield Sentry Financial Statements as of 12/31/2006 note 3.6.1 (Duffy Decl. at Exh. I). All the activities of the Funds were outsourced to third parties. Approximately 3.5% of Sentry's assets were invested in non-Madoff funds, and *Id*. at 18 96.5% in Madoff.

the Funds, to perform "transaction testing on the investment strategy" used by the Funds – as purportedly directed by the Investment Managers of the Funds (Audit Plan at 1; *see also* Fairfield Sentry Financial Statement as of 12/31/2006, note 3.6.1). The purpose of this and other promised testing was to provide assurance to Plaintiffs concerning the Funds' financial statements.[25]

PwC knew that it was the only independent source of this assurance. As alleged in the SCAC, it "knew that there was no independent market mechanism or evidence to value the shares and limited partnership interests in the Funds and that there was no other independently-verified third party financial information about the Funds besides [PwC's] audited financial statements." (SCAC ¶ 279; *see also* Audit Plan at 12-13.) Moreover, as the SCAC further alleges, "PwC knew that its name was used by the Funds in marketing so as to give the Funds legitimacy and, therefore, to draw investors to the Funds," and it further "knew that the audit letters would be provided or made available to potential investors and to existing investors." (SCAC ¶277.) Consistent with that knowledge, PwC actually addressed its audit reports to the partners and shareholders of the Funds. (*Id*. ¶275.) PwC's knowledge of the Funds' dealings with Madoff was heightened by reason of its wide-ranging involvement in the auditing of Madoff feeder funds. For example, as of 2007, "PwC alone was auditing [at least nine] Madoff 'feeder funds' which had assets under management that approximated the total amount of Madoff's SEC-reported assets under management." (*Id.* ¶274.) By virtue of its extensive knowledge of the operations of feeder funds, including the Funds here, PwC knew that the real

[25] In addition to providing audited financial statements, Greenwich Sentry and Greenwich Sentry Partnership further assumed the duty to provide each partner's capital account and partnership percentage tax statements, and PwC was engaged for this purpose. In addition, the auditors were to provide transaction reports to limited partners so that they could prepare their individual tax returns.

value in any audit of the Funds was to report to the investors on the reliability of the Funds' reporting on their investments in Madoff. Against the backdrop of the SCAC's allegations, PwC's assertion that "the complaint does not even pay lip service to the requirement of a 'relationship approaching that of privity' – let alone plead facts supporting such a relationship" (*PwC Canada Brf.* at 20) is simply empty rhetoric.

New York courts have long recognized that facts such as those pled here establish "near privity" with an auditor. As noted in *Credit Alliance*, in 1922 the court in *Glanzer*, recognizing that "[t]here is nothing new here in principle," held bean weighers liable to the buyer of the beans, despite the lack of contractual privity, because the buyer's "use of the [weight] certificates was not an indirect or collateral consequence of the action of the weighers. It was a consequence which, to the weighers' knowledge, *was the end and aim of the transaction*." 233 N.Y. at 238-39 (emphasis supplied). One need not go beyond PwC's own documents to establish that the "end and aim" of the audits addressed to Plaintiffs was to "assure" them about the soundness of the Funds' financial statements.

The principle of "near privity" was specifically extended to auditors in *White v. Guarente*, 43 N.Y.2d 356 (N.Y. 1977), where a limited partner in an investment fund sued the fund's auditor for negligence in performing professional services. The court held that the limited partner could sue the auditor because the auditor's "assumption of the task of auditing [the limited partnership] and preparing the [tax] returns was the assumption of a duty to audit and prepare carefully for the benefit of those in the fixed, definable and contemplated group whose conduct was to be governed," the limited partners. *Id.* at 361-62. As is the case here, near

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Greenwich Sentry Fund Confidential Offering Memorandum dated August 2006 at §§8.03-8.04 (Thorne Decl. at Exh. 3).

privity existed because "the furnishing of the audit and tax return information, necessarily by virtue of the relation, was one of the ends and aim of the transaction." *Id.* at 362.

More recently, in *Cromer Fin. Ltd. v. Berger*, 2003 WL 21436164 at *12, the court sustained the right of an investor in a fund to sue the fund's auditors for negligent misrepresentation. The court denied the auditors' summary judgment motion, noting that the auditors addressed the audit reports to the funds' shareholders and holding that the *Credit Alliance* criteria were met because, "[b]ased on the accountant's knowledge, the consequence [of plaintiffs' reliance on the audit] must have been the 'end and aim of the transaction.'" *Id.* That conclusion is all the more compelling here, where PwC has not only addressed its reports to plaintiffs, but has acknowledged doing so pursuant to an obligation owed Plaintiffs to provide them with "assurance" by way of the audits.

Contrary to PwC's characterization of the law, courts have repeatedly sustained negligent misrepresentation claims against accountants by parties not in contractual privity with them. *See, e.g., AUSA Life Ins. Co. v. Ernst & Young*, 206 F.3d 202, 223 (2d Cir. 2000) (privity existed under *Credit Alliance* because "[t]o the extent that the 'no-default' letters were intended to serve the purpose of conveying to the investors that the notes which they held were not in default, E&Y knew what the letters were for and E&Y knew for whom the letters were intended . . ."); *Dinerstein v. Anchin, Block & Anchin*, 838 N.Y.S.2d 46 (N.Y.A.D. 1st Dep't 2007) (in a claim by shareholder, court denied auditor's motion for summary judgment in part because the "audit reports…were addressed to 'the Stockholders and Directors of [the company]'"); *Barrett v. Freifeld*, 883 N.Y.S. 2d 305 (N.Y.A.D. 2nd Dep't 2009) (court allowed negligence claims to proceed because sufficient facts alleged "to suggest" that the accountants "were aware" that seller would use financial statements in connection with sale of a business).

Here, PwC's own Audit Plan affirms that PwC was engaged to deliver services to shareholders: "Our audit engagement is directed towards delivering our service at three levels," a specific one being shareholders. (Audit Plan at 8; *see also* SCAC ¶276.) The Audit Plan further acknowledged the value of the audits to the limited partners and shareholders, characterizing the value of its audit reports to "shareholders and stakeholders" as "independent opinions and reports that provide assurance on financial information released by the funds." (Audit Plan at 8.) Consistent with that aim of the audits, each of the Funds in its offering documents assumed an obligation to provide audited financial statements to its investors (*see e.g.*, Fairfield Sentry PPM dated August 14, 2006 PPM at 32; Greenwich Sentry Confidential Offering Memorandum ("COM") dated August 2006 at 6 (Thorne Decl. Exh. 1, 3)).

PwC's attempt to deny its knowledge of the purpose of the audits fails to comport not only with its own stated view of its obligations, but with the realities of the marketplace. The inclusion in an audited financial statement of anything less than an unqualified opinion would have sent a dire signal to the Funds' partners, shareholders, and potential investors, with serious consequences for the Funds. *See, e.g., United States v. Arthur Young & Co.*, 465 U.S. at 819 n.14.

Further, PwC knew that its name and reputation were invoked by the Funds, and allowed it. For example, the Funds' PPMs and COMs identified PwC as the auditor of the Funds, which necessarily occurred with PwC's consent, a fact that PwC studiously avoids in its motion. (Engagement Letter dated October 17, 2007 p.1 (Duffy Decl. at Exh. C) and Appendix, Terms and Conditions, §25.) PwC allowed the Fairfield Sentry Fund to attach audited financial statements as an Appendix to the Fairfield Sentry PPMs (see PPMs dated July 1, 2003; October 1, 2004 (Thorne Decl. Exh. 12, 13)). The importance to investors of having a reputable accounting firm auditing the Funds cannot be overstated. *See, e.g., United States v. Arthur*

Young & Co., 465 U.S. at 817-18; SECURITIES AND EXCHANGE COMMISSION'S AMENDMENT TO RULE 102(E) OF THE COMMISSION'S RULES OF PRACTICE, Release No. 34-40089 (October 19, 1998), available at http://www.sec.gov\rule\final\33-7593.htm. PwC does not (nor could it) assert that, if it had issued opinions that Funds' assets were non-existent, Plaintiffs would not have acted on those opinions. PwC's argument at its core ignores the acknowledged fact that it agreed to provide audited financial statements to Plaintiffs each year in order to provide "assurances" that their investment was sound.

3. The Plaintiffs Were Parties Known to PwC.

PwC Canada does not dispute that investors in the Funds were known parties who would rely on the audits for their intended purpose.[26] PwC Netherlands, on the other hand, attempts to contest that indisputable fact by misapplying *Credit Alliance* when it (incorrectly) asserts that the complaint "does not allege that PwC Netherlands issued any report specifically to any of the particular plaintiffs or even knew of the existence of any particular plaintiff." (*PwC Netherlands Brf.* at 20.)

First, the SCAC specifically alleges that PwC Netherlands directed its various audit reports to the Funds' partners and shareholders, as appropriate. (SCAC ¶275.) For example, PwC Netherlands addressed the FY 2003 audit report dated June 29, 2004 (Vickery Decl. at Exh. 13), issued on the financial statements of Fairfield Sentry Limited, "To the directors and shareholders of Fairfield Sentry Limited."

Second, to the extent PwC Netherlands' contention is that it must have been aware of, and provided its audit reports to, a "particular" member of the particularized class made up of Plaintiffs, it misapprehends *Credit Alliance*. The "known parties" prong of the *Credit Alliance*

[26] PwC Canada disputes only that prospective investors were known parties. (*PwC Canada Brf.* at 20.)

test does not require an auditor know a "particular" non-privity party by name. Rather it recognizes that while an accountant does not owe a duty to members of an "indeterminate class," *Ultramares Corp. v. Touche*, 255 N.Y. 170, 184 (N.Y. 1931), an accountant owes a duty to "[members] of a particularized class among the members of which [a] report would be circulated…." *White v. Guarente*, 43 N.Y.2d 356, 363 (N.Y. 1977). That is precisely the case here, where Plaintiffs were members of a small, particularized class to which PwC directed its audit reports (SCAC ¶ 275). *See Duke v. Touche Ross & Co.*, 765 F. Supp. 69 (S.D.N.Y. 1991) (granting known-party status under New York law where the accountant's report was disseminated to a "select group of qualified investors").

The cases upon which PwC Netherlands mainly relies (*PwC Netherlands Brf.* at 20-21) are inapposite. In fact, the court in *SIPC v. BDO Seidman, LLP*, 222 F.3d 63, 74 (2d Cir. 2000), in one of the cases, recognized that plaintiffs in *White* qualified as known parties because "the accounting firm knew, when it agreed to perform an audit, that a group of limited partners, including the plaintiff, would rely on that audit in preparing their tax returns." *Id.* The *BDO Seidman* court only held that a broker dealer's customers, who were not known to the accounting firm and to whom the accountant had not addressed its audit reports, were not "known parties" within the meaning of *Credit Alliance*. *Id.* at 75. Of course, that is a far cry from the situation here, where PwC knew that the investors in the Funds would rely on its audit opinions and thus acknowledged it was "responsible for reporting to the…shareholders and/or partners on the financial statements of the Funds," (SCAC ¶276; *quoting* Audit Plan at 8) through "independent opinions and reports that provide assurance on financial information released by the funds." (Audit Plan at 8.) In light of an acknowledged obligation to provide accurate audit reports to Plaintiffs, PwC's assertion that those parties were not known to it is baseless.

In *Westpac Banking v. Deschamps*, 494 N.Y.S. 2d 848 (1985), a lender unknown to the auditor claimed that the auditor nevertheless knew its client would seek a bridge loan and thus "had a duty to potential bridge lenders, including" the plaintiff. But there the auditor did not even know that its report was being shown to the plaintiff lender (*id.* at 19). Here, in contrast, PwC addressed its report to Plaintiffs directly in recognition of its duty to report to them.

The plaintiff in *Parrot v. Coopers & Lybrand, LLP*, 95 N.Y.2d 479, 483-85 (2000), was a former employee of the auditor's client who sold back his shares to the auditor's client at a valuation determined by the auditor. Near privity did not exist because the auditor did not know its reports would be used in connection with the plaintiff's stock sale, particularly since it did not even know that the plaintiff owned stock or that its audit report would be used to establish its sale price. *Id.* at 484. Finally, PwC's reliance on *Parrot* and *Sec. Pac. Bus. Credit, Inc. v. Peat Marwick Main & Co.*, 586 N.Y.S. 2d 87 (N.Y. Ct. App. 1992), for the proposition that it owed no duty to plaintiffs because its work was "unrelated" (*PwC Netherlands Brf.* at 21) to their investments in the Funds is gutted by PwC's contemporaneous acknowledgment that the reports it directed to Plaintiffs were intended to "provide assurance on financial information released by the funds." (Audit Plan at 8.)

4. The Requisite Linking Conduct Existed Between PwC And Plaintiffs.

As the court held in *Cromer Finance Ltd. v. Berger*, 2001 WL 1112548 at *5 (Sept. 19, 2001 S.D.N.Y), "audit reports addressed 'to the shareholders,' constitute 'substantial communication' between [the auditor] and the plaintiff-shareholders sufficient to satisfy the 'linking conduct' requirement" of *Credit Alliance*. That simply disposes of PwC's contrary argument, given the SCAC's allegations. (¶¶ 275-276, 279.) In any event, contrary to PwC's argument, direct contact between an auditor and non-privity party is unnecessary to establish

"linking conduct." *Dorking Genetics v. United States*, 76 F.3d 1261, 1270 (2d Cir. 1996) (rejecting narrow reading of "linking conduct" requirement and construing *Credit Alliance* to permit action "even if the plaintiffs had never interacted directly with the defendant"). Having addressed the audit reports in question to Plaintiffs as shareholders and partners in the Funds so as to provide them "assurance" about the Funds' financial condition (*i.e.*, their investments), PwC cannot now credibly claim that there was no "linking" conduct between itself and Plaintiffs.

Once again, PwC's cases do not contradict this conclusion. For example, in *Katz v. Image Innovations Holdings, Inc.*, 2008 WL 4840880, at *9 (S.D.N.Y. Nov. 5, 2008), the case upon which it principally relies, the CEO of a company claimed that he was induced to join the company based on false representations as to the company's revenues. In addition to suing those who made the representations, he sued the company's auditors, claiming that they had negligently represented the company's financial situation in draft reports prior to his hiring. In rejecting the claim, the court held that there was no allegation that the plaintiff's purported reliance on the "financials in deciding whether to become CEO was ever discussed, acknowledged or understood by [the auditor and plaintiff] and there is no plausible claim that an end and aim of [the auditor's] preparing [the company's] financials was to include [plaintiff's] reliance on them, or to induce through such reliance his agreement to become CEO." *Id.* The facts in *Katz* offer no basis to dismiss Plaintiffs' claims in this case.

Similarly, in *BDO Seidman*, 222 F.3d at 75, there had been no contact between the auditor and its broker-dealer-client's customers. That is not the case here, where PwC issued audit reports directed to the Funds' shareholders and partners. (SCAC ¶275.) In fact, the court in that case distinguished the situation, which would establish linking, where the accountant provides its opinions to plaintiffs, as happened here where PwC directed its audits to Plaintiffs. In *Sec. Pac. Bus. Credit, Inc.*, 79 N.Y.2d at 704-7, a lender sued its borrower's auditor

concerning an SEC-required audit. On summary judgment, the court found that the lender's effort to establish linking conduct was unavailing because the lender "primarily relie[d] on [a] single phone call" with the auditor to establish linking conduct and there was no evidence that the auditor "shaped" the audit to meet the needs of the lender or even that it provided the lender with a copy of the audit. *Id*. at 706. PwC's assertion that plaintiffs have alleged "no conduct different than what has been held insufficient in these cases" is palpably wrong. On the contrary, the facts pled in the SCAC satisfy each of the *Credit Alliance* requirements (*see, e.g*., SCAC ¶¶ 275, 276, 279, 435, 436), thus properly stating a claim for negligence against PwC. PwC's motion to dismiss the claim should therefore be denied.[27]

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[27] PwC Canada contends in a footnote (*PWC Canada Brf.* at 21, fn. 7) that Plaintiffs' claims for negligent misrepresentation would be barred under Canadian law citing the Supreme Court of Canada's decision in *Hercules Management Ltd. v. Ernst & Young* [1997] 2 S.C.R. 165 (Duffy Decl., Exh. R). The case is distinguishable because the court found that the defendant accountants prepared their audit reports pursuant to a requirement of the Manitoba Corporations Act that shareholders be provided with audited financial reports for the purpose of overseeing the management and affairs of the company at the annual meeting of shareholders. In this case, the SCAC alleges that the Funds provided audited financial statements to investors for the purpose of inducing them to invest and remain invested in the Funds. PwC specifically addressed the audited financial reports to shareholders and limited partners. There is no requirement under B.V.I. law or the Articles of the two funds that annual meetings of the shareholders be held or that audited financial statements be provided to shareholders (Hunte Aff. at ¶27); Fairfield Sentry Amended Articles of Association, §20(1); BVI Business Companies. Act, 2004 §82. In fact, no general shareholders meetings were ever held. Similarly, PwC has not cited any statutory requirement under Delaware law that limited partners be provided with audited financial statements.

The Supreme Court of Canada's decision in *Haig v. Bamford* [1977] 1 S.C.R. 466 is on all fours with the facts of this case (a copy of *Haig v. Bamford* is appended to the Vickery Decl. as Exh. 18). In *Haig* the defendant accounting firm knew that it had been retained to prepare a financial statement that would be used by its client to solicit investments in the company, although it was not told from whom. The audit statement was negligently prepared. Like PwC, the auditor did not go to the trouble of checking invoices and purchase orders or inquire as to internal controls to determine whether the company's accounts were accurate. Instead of being profitable as represented in the audited financial statement, the company was operating at a loss. In reliance on the decision of the House of Lords in *Hedley Byrne*, the court held the accountants liable to the investor because the accountants "knew that the financial statements were being prepared for the very purpose of influencing … a limited number of potential investors." 1 S.C.R. at 478. The Supreme Court found that the facts were closer to *Glanzer* than *Ultramares*. "The very end and aim of the financial statements prepared by the accountants in the present case was to secure additional financing for the company from Sedco and an equity investor; the

C. Count 15 States a Viable Cause of Action for Third-Party Breach of Contract against PwC Canada and PwC Netherlands.

At the pleading stage, all that Plaintiffs need to allege is a contract between PwC and the Funds of which Plaintiffs were intended beneficiaries. *Andreo v. Friedlander, Gaines, Cohen, Rosenthal & Rosenberg*, 660 F. Supp. 1362, 1373-74 (D. Conn. 1987) (Plaintiff merely has to set forth a short and plain statement of the claim to be a third party beneficiary. The specific language of the contract or intent of the parties to create a direct obligation to plaintiffs is a matter of proof, not of pleading); *Zurich Capital Mkts., Inc. v. Coglianese*, 2005 WL 1950653, at *8-9 (N.D. Ill. Aug. 12, 2005) (All plaintiff has to plead are "the existence and scope of the agreement and that [plaintiff] was a third party beneficiary to the agreement."). The SCAC adequately pleads those facts.

1. The Parties Intended to Benefit the Funds' Investors as Third-Party Beneficiaries of the Agreements to Audit the Funds' Financial Statements

Under the RESTATEMENT (SECOND) OF CONTRACTS §302 (1981), adopted by New York, a party will be deemed an intended beneficiary of a contract if "recognition of the beneficiary's right to performance … [is] appropriate to effect the intention of the parties," and if "'the circumstances indicate that the promisee intends to give the beneficiary benefit of the promised performance.'" *Fourth Ocean Putnam Corp. v. Interstate Wrecking Co., Inc.*, 495 N.Y.S.2d 1, 44 (N.Y. Ct. App. 1985) *quoting* RESTATEMENT (SECOND) OF CONTRACTS §302. The promise to benefit the third party does not have to be expressly stated in the contract. *Trans-Orient Marine Corp.* v. *Star Trading & Marine, Inc.*, 925 F.2d 566, 573 (2d Cir. 1991) ("it is well-settled that

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statements were required primarily for these third parties and only incidentally for use by the company." 1 S.C.R. at 482. Here, the SCAC clearly alleges that the Funds commissioned financial statements for the purpose of inducing investors to purchase and retain shares.

the obligation to perform to the third party beneficiary need not be expressly stated in the contract.").

The contracts here are the engagement letters between the Funds and PwC and the audit plans outlining the nature and scope of PwC's obligations.[28] The PwC Canada engagement letter dated November 8, 2008 makes clear the parties understanding that PwC would provide auditing services for the benefit of the shareholders of the Funds: "as the Funds' auditor, we are responsible for reporting to the directors, shareholders and/or partners on the financial statements of the Funds…" (PwC Canada Engagement letter dated Nov. 8, 2008 at 8). The Audit Plan is to similar effect: "Our audit engagement is directed towards delivering our service at three levels," the first level being the shareholders, and the services being "independent opinions and reports that provide assurance on financial information released by the Funds." (Audit Plan at 8). Those documents evidence a clear intent on the part of the Funds and PwC to benefit the shareholders and limited partners of the Funds.

The surrounding circumstances reinforce that conclusion. Each of the Funds in its offering documents voluntarily assumed an obligation to provide audited financial statements to its investors (*see e.g.*, Fairfield Sentry PPM dated August 14, 2006 PPM at 32; Greenwich Sentry COM dated August 2006 at 6). Fairfield Sentry and the Fairfield Sigma were not required to provide investors with audited financial statements under B.V.I. law. Hunte Affidavit, ¶27. Nor did Delaware law require Greenwich Sentry or Greenwich Sentry Partners to provide audited financial statements to the limited partners. The directors of the Funds did not need audited financial statements to manage the affairs of the Funds. Thus, there was no reason why the

[28] *See* PwC Canada engagement letters dated November 8, 2008 appended to the Audit Plan as Appendix A; PwC Canada engagement letter dated October 17, 2007, Duffy Decl. at Exh. C; PwC Canada

Funds went to the expense of hiring independent auditors to certify their financial statements, except to assure potential and existing investors that the Funds were sound investments.[29] It is for that reason the Funds contracted with PwC to provide the audit reports to the shareholders and partners of the Funds. The fact the reports were addressed to the investors is strong evidence that they were intended beneficiaries of the agreements between the Funds and PwC.[30] *Flickinger v. Harold C. Brown & Co., Inc.*, 947 F.2d 595, 600 (2d Cir. 1991) (third party an intended beneficiary where performance is rendered directly to it); *Subaru Distributors Corp. v. Subaru of America, Inc.*, 425 F.3d 119, 124 (2d Cir. 2005) (same).

In addition, with PwC's consent and knowledge, the Funds' PPMs and COMs identified PwC as the auditor of the Funds. (*See e.g.*, SCAC ¶278 referencing PwC Canada engagement letter dated October 17, 2007 p.1 and Appendix, Terms and Conditions, §25). Moreover, PwC even consented to the Fairfield Sentry Fund attaching audited financial statements to the Fairfield Sentry PPMs (see PPMs dated July 1, 2003; October 1, 2004 (Thorne Decl. at Exh. 12, 13)). PwC was obligated in the course of its audits to review the Funds' PPMs and COMs, and was fully aware that its name was being used in the offering documents. (SCAC ¶¶ 277-278)

In *Department of Economic Development v. Arthur Andersen & Co. (U.S.A.)*, 924 F. Supp. 449 (S.D.N.Y. 1996), the court found a material issue of fact precluding summary judgment with respect to whether two governmental investors were intended beneficiaries of a

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engagement letter dated January 11, 2007, *id*. at Exh. A; PwC Netherlands engagement letter dated February 7, 2006, Vickery Decl. at Exh. 12.

[29] The investors, of course, indirectly paid for the audits because expenses of the Funds were deducted from the assets of the Funds. This is yet another reason for finding that the investors were intended beneficiaries of the contracts with PwC.

[30] *See e.g.*, Fairfield Sentry – Report of Independent Auditors for the year ended 12/31/2007 (Duffy Decl. at Exh. I); Fairfield Sigma – Report of Independent Auditors for the year ended 12/31/2007 (*id*. at Exh. J); Greenwich Sentry L.P. – Report of Independent Auditors for the year ended 12/31/2007 (*id*. at Exh.

contract between the DeLorean Motor Company and Arthur Andersen for auditing services, despite the fact that the engagement letters made no mention of the governmental investors. *Id.* at 482-85. The court found based on surrounding circumstances that DeLorean had retained the auditor in order to fulfill a condition of the contract with the investors, rather than simply to fulfill routine public filing requirements. *Id.* at 485. Plaintiffs have a stronger basis for claiming to be intended beneficiaries. Here, the Audit Plan expressly states that services are to be rendered to the shareholders and limited partners of the Funds. In addition, the Funds undertook voluntarily in the PPMs and COMs to provide investors with audited financial statements. The Funds retained PwC in furtherance of this duty. In marked contrast to *Department of Economic Development*, PwC addressed the audited financial statements to the shareholders and partners in the Funds in order to assure them of the financial condition of the Funds.

2. The Boilerplate Disclaimer in the PwC Canada Engagement Letter Was Superseded by the Audit Plan and PwC's Conduct in Addressing the Financial Statements to Investors

PwC Canada seeks to avoid liability to the Funds' investors based on a boilerplate disclaimer in its engagement letters that reads:

> **Reliance by Third Parties:** The financial statement audit will not be planned or conducted in contemplation of reliance by any specific third party or with respect to any specific transaction. Therefore, items of possible interest to a third party will not be specifically addressed and matters may exist that would be assessed differently by a third party, possibly in connection with a specific transaction.

PwC's conduct and the Audit Plan vitiate the boilerplate disclaimer. At the least, the term "third parties" in the disclaimer should *not* be read to include shareholders or limited partners of the Funds that were the intended beneficiaries of the audits, but rather other third

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L); Greenwich Sentry Partners, L.P. – Report of Independent Auditors for the year ended December 31, 2007 (*id*. at Exh. K.).

parties who might rely on the audited financial statements (*e.g.*, lenders, insurers or counterparties). As discussed earlier, PwC Canada addressed the audited financial statements to shareholders and limited partners of the Funds and cannot now claim that they are "third parties" not entitled to rely upon them. *BHC Interim Funding L.P. v. Finantra Capital, Inc.*, 283 F. Supp. 2d 968, 986 (S.D.N.Y. 2003) (affirmative conduct by auditor can overcome boilerplate disclaimer). PwC knew that its audits would be provided or made available to potential and existing investors in the Funds. (SCAC ¶277.) PwC acknowledged that the audits were intended to provide "assurance" to the partners and shareholders. (Audit Plan at 8.) In light of these facts PwC's assertion that it was unaware of any contemplated use that shareholders and limited partners might make of the financial statements is flatly not credible and cannot be given any weight in deciding a motion to dismiss. PwC's conduct belies that assertion; it addressed the audits to the shareholders and partners in recognition of an obligation to provide assurances as to the financials and permitted the Fairfield Sentry Fund to distribute its audited financial statements along with the offering memoranda. Consequently, the engagement letter's statement that the audit would not be planned to address concerns of third parties cannot reasonably be read to apply to the investors in the Funds for whose benefit the audit opinions were intended.

D. The SCAC States Viable Claims for Aiding and Abetting Breach of Fiduciary Duty and Fraud against PwC Canada and PwC Netherlands

1. PwC Canada and PwC Netherlands Aided and Abetted Breach of Fiduciary Duty

A claim for aiding and abetting breach of fiduciary duty has three elements: "(1) a 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), *citing In re Sharp Int'l. Corp*., 403 F.3d 43, 49 (2d Cir. 2005).

PwC Canada and PwC Netherlands assert that Plaintiffs do not plead facts supporting a claim that PwC knowingly participated in or substantially assisted the FGG Defendants' breach of fiduciary duty. (*PwC Canada Brf.* at 23; *PwC Netherlands Brf.* at 22.). The actual knowledge requirement is satisfied where there is sufficient circumstantial evidence to give rise to an inference of knowledge. *Pension Committee of University of Montreal Pension Plan v. Banc of America Securities LLC*, 2007 WL 528703, at *7 (S.D.N.Y. Feb. 20, 2007). In *Pension Committee*, the court denied a motion to dismiss against the administrator of an investment fund, finding that the series of "red flags" the administrator ignored supported an inference that he had knowledge of the underlying breach of fiduciary duty and fraud. *Id*. Later in the same case, the court denied a motion for summary judgment by the fund's prime broker/custodian on the same aiding and abetting claim, finding that a jury could find that the prime broker had actual knowledge of the breach and fraud based on circumstantial evidence, which included inconsistencies in the trades and values the fund reported to the prime broker. *Pension Committee of University of Montreal Pension Plan v. Banc of America Securities, LLC*, 652 F. Supp. 2d 495, 510 (S.D.N.Y. 2009). Moreover, it is sufficient to allege willful blindness or conscious avoidance to satisfy the knowledge element. *See Cromer Fin. Ltd. v. Berger*, 2003 WL 21436164, at *9 (S.D.N.Y. June 23, 2003).

Plaintiffs allege that PwC ignored numerous red flags, including the lack of transparency into Madoff's operations, the lack of segregation of duties, the inadequate auditing of Madoff, contradictory facts, and the dubious consistent profitable returns for a fund pursuing Madoff's stated investment strategy. (SCAC ¶457b.) Combined with PwC's actual knowledge that BMIS executed the Funds' trades electronically but provided only delayed paper trade confirmations

(SCAC ¶272), and that as of the end of 2007 PwC alone was auditing Madoff feeder funds with assets under management that totaled in aggregate almost as much as BMIS claimed to manage (SCAC ¶274), Plaintiff has alleged facts sufficient to give rise to an inference that PwC had actual knowledge of the FGG Defendants' breach of fiduciary duty to the Plaintiffs.

Additionally, PwC was willfully blind to the FGG Defendants' breaches of fiduciary duty to the Plaintiffs based on PwC's complete failure to perform even the most basic audit procedures required by the auditing standards, and its knowledge that the FGG Defendants did not, in fact, conduct the due diligence they claimed to perform (SCAC ¶¶ 316, 317). Plaintiffs also allege that PwC "willfully ignored that the [FGG] Defendants did not monitor or verify the investments purportedly made by Madoff" (*id*. ¶317), yet turned a blind eye and "refrained from confirming it in order later to be able to deny knowledge." *See Fraternity Fund Ltd. v. Beacon Hill Asset Mgmt., LLC*, 479 F. Supp. 2d 349, 368 (S.D.N.Y. 2007).

The second element of a claim for aiding and abetting breach of fiduciary duty is satisfied where "a defendant affirmatively assists, helps conceal or fails to act when required to do so, thereby enabling the breach to occur." *Lerner v. Fleet Bank, N.A.*, 459 F.3d 273, 295 (2d Cir. 2006). Plaintiffs allege that PwC substantially assisted the FGG Defendants in their breach of fiduciary duty by issuing clean audit opinions on the Funds. (SCAC ¶318.) Contrary to PwC's attempt to minimize that allegation, PwC's clean audit opinions were an affirmative statement that an audit had been performed applying appropriate auditing standards and that the financial statements accurately presented the financial conditions of the Funds, without which the Funds

would have been essentially unmarketable. In essence, PwC knowingly failed to properly audit, thus assisting the FGG Defendants' breach of duty.[31]

2. PwC Aided and Abetted the FGG Defendants to Commit Common Law Fraud

The requirements of a claim for aiding and abetting fraud are similar to aiding and abetting breach of fiduciary duty: "'(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, *quoting Gabriel Capital, L.P. v. NatWest Fin., Inc*., 94 F. Supp. 2d 491, 511 (S.D.N.Y. 2000). An aiding and abetting fraud claim is subject to the particularity pleading requirements of FED. R. CIV. P. 9(b). *Kottler*, 607 F. Supp. 2d at 464 (internal citations omitted). Actual knowledge can be inferred from circumstantial evidence, *see JP Morgan Chase Bank v. Winnick*, 406 F.Supp.2d 247, 253 (S.D.N.Y. 2005), or as described *supra*, conscious avoidance. *See Fraternity Fund Ltd*., 479 F. Supp. 2d at 368. This Court has held that facts tending to show conscious disregard or recklessness are sufficient to give rise to the strong inference of actual knowledge required to survive a motion to dismiss. *OSRecovery, Inc. v. One Groupe Int'l, Inc*., 354 F. Supp. 2d 357, 378 (S.D.N.Y. 2005). Here, the facts alleged in the SCAC (*see* ¶¶ 457b, 272, 274) not only show that PwC was reckless in its audits of the FGG Defendants, but meet the requirements of Rule 9(b). Plaintiffs also allege that PwC was willfully blind in conducting its audits and misrepresented the audits by stating they had been conducted in accordance with GAAS or ISA.

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[31] The allegations in the SCAC are a far cry from the sparse allegations PwC points to in *In re Santa Fe Pac. Corp. S'holder Litig.*, 669 A.2d 59, 72 (Del. 1995) where the plaintiffs "merely include[d] a conclusory statement that '[Defendants] had knowledge of the Individual Defendants' fiduciary duties and knowingly and substantially participated and assisted in the Individual Defendants' breaches of fiduciary duty…'." *Id.* Further, the issuance of the clean audit opinion by PwC here is more than the mere "inadvertent assistance" plaintiffs allege in *Bullmore v. Ernst & Young Cayman Islands*, 846 N.Y.S. 2d 145, 148-49 (1st Dep't 2007).

(SCAC ¶¶ 261-62, 318.) Plaintiffs further allege that PwC was willfully blind when it "ignored [the fact] that the [FGG] Defendants did not, in fact, conduct the due diligence they falsely represented that they conducted." (*Id*. ¶317.)

PwC's reliance on *VTech Holdings, Ltd. v. PricewaterhouseCoopers, LLP*, 348 F. Supp. 2d 255 (S.D.N.Y. 2004), is misguided. There, plaintiffs attempted to meet the knowledge requirement by alleging mere access to Lucent's books, which this Court found to be inadequate to establish constructive knowledge. *Id*. at 269. In this case, Plaintiffs allege that PwC affirmatively turned a blind eye to the fraud and misrepresented its audits. (SCAC ¶¶ 261-62, 318.) The case of *Ryan v. Hutton & Williams*, 2000 WL 1375265 (E.D.N.Y. Sept. 20, 2000), where the allegations simply discussed suspicions of fraud as opposed to actual knowledge, is also inapposite.

E. New York Recognizes a Cause of Action for Gross Negligence

New York courts do recognize a claim of gross negligence against accountants. *See Meinhard-Commercial Corp. v. Sydney*, 487 N.Y.S.2d 7 (N.Y. App. Div. 1st Dep't 1985) (denying motion to dismiss claims of negligence and gross negligence against accountants in connection with preparation of financial statements); *Foothill Capital Corp. v. Grant Thornton LLP*, 276 715 N.Y.S.2d 389 (N.Y. App. Div. 1st Dep't 2000) (finding that claims of gross negligence and recklessness against accountants in connection with preparation of audit reports met pleading requirements of particularity).

F. Plaintiffs' State Law Claims against PwC Netherlands are not Time-Barred

PwC Netherlands concedes that Plaintiffs' state law claims based on its 2005 audit report are timely, but contends that New York's three year statute of limitations for professional malpractice codified in N.Y. C.P.L.R. §214(6) (2009) bars similar claims in connection with the

audit reports it prepared for 2002, 2003 and 2004. Dismissal of the claims at this stage in the proceedings would be premature because the SCAC alleges sufficient facts that the statute of limitations was tolled by PwC's "continuous representation" of the Funds. *Williamson v. PricewaterhouseCoopers LLP*, 840 N.Y.S. 2d 730 (N.Y. Ct. App. 2007).

The SCAC alleges that PwC Netherlands and the Funds had a "mutual understanding that PwC would continue indefinitely to provide recurring auditing and related services to the Funds." (SCAC ¶259.) In its engagement letter dated February 7, 2006 (a copy of this letter is appended to the Vickery Decl. as Exh. 12),[32] PwC Netherlands referred to "our ongoing appointment as auditors of the Fairfield Funds" and stated that "this engagement is also effective for years subsequent to 2005, until it is replaced by a new engagement letter, unless the engagement is terminated." (*Id.*). These averments sufficiently plead that the parties mutually contemplated that PwC would continue to audit the Funds indefinitely and are sufficient to invoke the continuous representation doctrine. *Symbol Technologies, Inc. v. Deloitte & Touche, LLP*, 888 N.Y.S.2d 538 (2d Dep't 2009) (continuous representation doctrine tolled statute of limitations where plaintiff alleged that the parties mutually contemplated that the auditor's work and representation would continue after the issuance of an audit/opinion and report for a particular year).[33] The primary purpose of retaining PwC was to verify the existence and value of the Funds' assets entrusted to Madoff and the effectiveness of the Funds' internal controls. This purpose continued from year to year. PwC was duty-bound to sound the alarm if it had any inkling that the Funds' investments were not what they purported to be.

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[32] Plaintiffs have not had the opportunity to conduct discovery because of the PSLRA stay. This is the only engagement letter between the Funds and PwC that Plaintiffs have seen. PwC Netherlands did not refer to any other engagement letters in its motion to dismiss and should not be permitted to introduce any such letters (if they exist) in its reply papers.

In addition to annual audits, the SCAC alleges that PwC Netherlands provided auditing, tax and other consulting services to the Funds "on a regular and recurring basis." (SCAC ¶260.) The SCAC adequately pleads the continuous representation doctrine and these allegations must be accepted as true for purposes of this motion to dismiss. *Arnold v. KPMG LLP*, 2009 WL 1514589, at *2 (2d Cir. June 1, 2009).

PwC Netherlands has not submitted affidavits or provided any form of documentary proof that it entered into separate engagement letters with the Funds each year for 2002, 2003 and 2004 for the provision of separate and discrete audited services and that no work was performed as to a particular year once the financial statements were certified. *Williamson*, 890 N.Y.S. 2d at 735. Although, with the PSLRA stay in effect, Plaintiffs have been deprived of the opportunity to seek documentary or other discovery regarding the relationship between PwC Netherlands and the Funds, the PwC Netherlands engagement letter dated February 7, 2006 and the allegations in the SCAC that PwC Netherlands continuously represented the Funds must be taken as true for purposes of this motion to dismiss. Accordingly, PwC Netherlands' statute of limitations argument raises factual issues that cannot be resolved on a motion to dismiss. *Buchwald v. The Renco Group*, 399 B.R. 722, 753-54 and fn. 96 (S.D.N.Y. Bankr. 2009) (dismissal on motion inappropriate where complaint raised inferences that continuous representation doctrine applied); *In re Investors Funding Corp.*, 523 F. Supp. 533, 548 (S.D.N.Y. 1980) (court denies motion to dismiss claims against accountants based on statute of limitations where parties raised disputed factual issues as to the applicability of the continuous representation doctrine, including the independence of each annual audit from prior audits).

[33] PwC's continuous representation of the Funds was not interrupted by the transfer of responsibility for the audits from one member of the PwC organization to another.

III. PWC INTERNATIONAL IS LIABLE FOR THE TORTIOUS ACTS OF PWC CANADA AND PWC NETHERLANDS

A. PwC International Is Vicariously Liable for the Torts of PwC Canada and PwC Netherlands

1. PwC International Exercised Effective Control over the PwC Member Firms

Plaintiffs have adequately alleged that PwC Canada and PwC Netherlands acted as agents of PwC International in conducting the audits and issuing the unqualified audit opinions on the Funds' financial statements, and thus PwC International is liable for the torts those PwC firms committed. PwC International cannot hold itself out as having the right to control the audits conducted by PwC member firms (SCAC ¶¶ 153, 268-269; PwC Articles of Association ("Articles"), §4.1)[34] so as to entice clients, and then deny that fact so as to avoid liability.

To plead vicarious liability under New York law, Plaintiffs must allege an "agreement between [a] principal and [an] agent that the agent will act for the principal and the principal retains a degree of control over the agent." *In re Parmalat Sec. Litig.*, 375 F. Supp. 2d 278, 290 (S.D.N.Y. 2005); *see also Cromer Finance Ltd. v. Berger*, 2002 WL 826847, at *4 (S.D.N.Y. May 2, 2002). Although the element of control is deemed the essential characteristic of the principal-agent relationship, *Parmalat*, 375 F. Supp. 2d at 290, control does not depend on whether PwC International actually controlled PwC Canada and PwC Netherlands, but rather whether PwC International had the ***right to control*** any ***aspect*** of PwC Canada's or PwC

[34] Courts may take judicial notice of an entity's articles of incorporation and bylaws. *See e.g., Logicom Inclusive, Inc. v. W.P. Stewart & Co.*, 2004 WL 1781009 (S.D.N.Y. Aug. 10, 2004). Copies of the PwC International's 2001 Memorandum of Association ("Charter") and Articles of Association ("Articles") are appended to the Vickery Decl. as Exh. 15 and Exh. 16, respectively.

Netherlands' conduct. The PwC Charter[35] and Articles[36] certainly demonstrate PwC International's right to control its member firms' conduct, audits and business.

Plaintiffs' agency allegations meet the notice pleading requirements of Rule 8. *Parmalat*, 375 F. Supp. 2d at 291. PwC International is the umbrella organization, which coordinates the accounting and auditing services for the various constituent PwC member firms. (SCAC ¶¶ 153, 268.) PwC International marketed itself and its member firms as a global auditing firm and reported the revenue for all member firms on a combined basis. (*Id.* ¶¶ 268-269.) *See also* 2008 Global Annual Review (cited at SCAC ¶294 ("2008 Review," Vickery Decl. at Exh. 14)) at 2.[37]

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[35] PwC International's role, as set forth in its Charter is:

> (i) to provide guidance in relation to, and assist in the achievement of the vision, values and principles of the member firms of [PwC International] and the ***co-ordination of, the management and governance of the member firms of*** [PwC International]….
>
> (ii) ***to develop, and promote*** and assist the development of, high ***common standards, principles, strategies, policies, objectives, plans, projects,*** programmes, ***practices and systems to be applied by the member firms***….and to promote, monitor and assist the uniform application of such high common standards, principles, strategies, policies, objectives, plans, projects, programmes, practices and systems;
>
> * * *
>
> (iv) to promot[e] and protect[] the names "PricewaterhouseCoopers" and "PwC"….

[36] As §4.1 of PwC International's Articles state:

> The Company may ***make*** and ***adopt regulations governing***, and establishing the rights and obligations of, ***the Company, its members***…***the Network firms***…in relation to, without limitation:
> (A) *the* ***admission*** of new members and of Network Firms
> (B) **the *resignation and expulsion* of members, Network Firms…and *automatic or other cessation of membership or status as Network Firms….***
> (E) the ***standards***, ***principles***, ***strategies***, ***policies***, ***objectives***, plans, projects, programmes, ***practices*** and ***systems to be observed and applied, and other obligations to be complied with***, by Member Firms, Network Firms…

[37] PwC International string cites decisions dismissing claims against accounting firms under the "unified company theory." *See e.g., In re WorldCom. Inc. Sec. Litig.*, 2003 WL 21488087 (S.D.N.Y. June 25, 2003); *In re Royal Dutch/Shell Transp. Sec. Litig.*, 380 F. Supp. 2d 509 (D.N.J. 2005); *Rocker Mgmt., LLC v. Lernout & Hauspie Speech Prods. N.V.*, 2005 WL 1365772 (dismissing §10(b) claims against KPMG US because its conduct was preparatory); *Skidmore Energy, Inc. v. KPMG, LLP*, 2004 WL 3019097 (N.D. Tex. Dec. 28, 2008); *Bamberg v. SG Cowen*, 236 F. Supp. 2d 79, 89 (D. Mass. 2002).

PwC International controls the actions of PwC member firms through a centralized global leadership structure. (SCAC ¶269; Declaration of Lawrence W. Keeshan, dated Aug. 24, 2007 ("*Keeshan Decl.*") at ¶¶ 5 7, 9-10, 12, 15-16, filed in *Allied Irish Banks, p.l.c v. Bank of America*, 03 civ 3748 (DAB) (S.D.N.Y.) (Dkt. No. 69), attached to the Vickery Decl. as Exh. 17.) As detailed in the SCAC, the leadership of the PwC's network is centralized in PwC International's Chairman and Chief Executive Officer, Global Board, Network Leadership Team, Strategy Council and Network Executive Team. (SCAC ¶269; 2008 Review at 34, 50.)[38] These governance bodies set the standards and strategy that PwC member firms must follow and have the power to enforce them. *See* (SCAC ¶269; *Keeshan Decl*. at ¶¶5, 7, 9-10, 12, 15-16.)[39]

PwC International actively participated in the decision making processes of its member firms and exercised general control over the operations of its member firms, including PwC Canada and PwC Netherlands. PwC Charter §3(a)(i)-(iv); Articles §4.1. PwC International set the audit strategy and standards its member firms – including PwC Canada and PwC Netherlands – must follow when conducting audits. *See e.g.*,2008 Review at 36; Presentation "The PwC Audit" at *http://aaahq.org/audit/midyear/04midyear/papers/The%20PwC%20Audit%20-*

None of those cases is instructive here. Plaintiffs in those cases only made bare allegations that the international audit firms were "unitary, worldwide firms" and that those firms hold themselves out to the world as one firm with accountants in offices worldwide. Here, as demonstrated above and in the SCAC, Plaintiffs have done more.

[38] From PwC Canada: Peter Tieleman presently serves on the Global Board and Robert Swaak presently serves on the Strategy Council. *See* 2008 Review.

[39] PwC International's Chairman and CEO oversees each of these managing boards and is a member of the Global Board and the Network Leadership Team. SCAC ¶269.[39] The Global Board's role is to ensure accountability, protect the PwC network, and ensure effective governance. *See* 2008 Review at 34, 50. The Network Leadership Team "sets the strategy and ***standards*** that the PwC network ***will follow***," and is comprised of partners of PwC International's member firms, including PwC International's CEO. *See id*. The Strategy Council sets strategic direction for the global PwC organization and ensures alignment in the execution of strategy, and is comprised of the senior partners of the largest PwC member firms. *Seeid*. Finally, the Network Executive Team, which reports to the Network Leadership Team, is responsible for

%20011704%20Presentation.ppt#453,1,The. PwC International also protected the PwC brand by reviewing the PwC member firms' operations, work and compliance with global standards.[40] PwC International disciplined partners and member firms for failure to adhere to its global policies and standards. *See e.g.,* Articles §4.1(B). These allegations sufficiently establish PwC International's vicarious liability at this stage.[41] *See Cromer*, 2002 WL 826847 at *2, *4; *In re Parmalat Sec. Litig.*, 474 F. Supp. 2d 547, 549 (S.D.N.Y. 2007).

PwC offices throughout the world collaborated in preparing the Funds' audits. PwC Bermuda, for example, conducted an interview with Madoff in December 2004 "for the purpose of gaining comfort thereon for the audits by several PwC offices of a number of funds having moneys managed by BLM [BLMIS]." (SCAC ¶271); PwC Report at 1. The PwC Report was then distributed to PwC Ireland and PwC Netherlands, among other offices.

At the pleading stage, the case law does not require that Plaintiffs allege that PwC International was actually involved in performing the Funds' audits. Rather, it requires that the SCAC plead — as it does — sufficient facts to show that PwC International exercised some control over the PwC member firms' operations and audits generally. *See e.g., Cromer*, 2002 WL 826847 at *2-3; *Parmalat*, 375 F. Supp. 2d at 287-88, 293-95. *Cromer Finance* held that

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key service lines and functional areas across the PwC network. *See id*. Partners from PwC Canada and PwC Netherlands served on the Global Board, Leadership Team and Strategy Council.

[40] *See* 2008 Review at 36.

[41] These allegations coupled with the fact that PwC International represented to Plaintiffs and others through its marketing materials and its global website that PwC is a global entity are sufficient to establish apparent authority. To plead the existence of apparent authority, plaintiffs must allege "words or conduct of the principal, communicated to a third party that give rise to the appearance and belief that the agent possesses authority to enter into a transaction on behalf of the principal." *Spagnola v. Chubb Corp.*, 2010 WL 46017, at *10 (S.D.N.Y. Jan 7. 2010) (internal quotations omitted). In *Spagnola*, the court found apparent authority between a parent corporation and its subsidiary based on allegations similar to the ones alleged here; the establishment of uniform practices and standards, the overlap in directors and senior management, the use of corporate logo, the coordination of marketing and

plaintiffs sufficiently demonstrated Deloitte Touche Tomatsu's ("Deloitte") "participation in the audits based on an agency theory" when Deloitte conveyed to the public and organized itself as a global entity, the member firms used Deloitte's name and logo, and a member of Deloitte's global investment management team was the partner in charge of the member firm that signed the audit reports. *Cromer*, 2002 WL 826847 at *2-3 (allowing plaintiffs to amend their complaint to compel defendants to respond to agency allegations).

Similarly, in *Parmalat*, the court upheld plaintiffs' allegations of vicarious liability against Deloitte and Grant Thornton International ("GTI"). The court noted that plaintiffs had alleged certain facts about the structural characteristics of Deloitte and GTI that allowed them to control the activities of their member firms. As to Deloitte, plaintiffs alleged that: (1) Deloitte marketed itself and its member firms as a global auditing firm and reported the revenue for all member firms on a combined basis; (2) member firms regularly cross checked each other's work to ensure quality; (3) member firms cooperated and joined together in submitting bids for audit services; (4) member firms used the Deloitte name and logo; and (5) there was an overlap in senior officers between Deloitte and its member firms. *Parmalat*, 375 F. Supp. 2d at 287-88, 293. As to GTI, the court found similar facts to hold it vicariously liable: (1) GTI marketed itself as a global accounting organization; (2) GTI required its member firms to follow certain auditing policies and procedures; (3) GTI reviewed each member firm every three years to ensure compliance; and (4) GTI could discipline member firms (including expulsion) for failure to comply with its policies and procedures. *Id.* at 288, 299-300. The court refused to make the

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advertising, and the reference to a single entity. *Id*. at *2, *10. PwC International's cases do not hold otherwise.

ultimate factual determination on a motion to dismiss "[w]hether this was simple collaboration ***or*** an agency relationship." *Id*. at 294-95.[42] (Emphasis supplied.)

Here, as in *Cromer Finance* and *Parmalat*, Plaintiffs allege sufficient facts to demonstrate that PwC International exercised control over the PwC member firms, including PwC Canada and PwC Netherlands.[43] The SCAC explains how PwC International is organized and how it functions. (SCAC ¶269); Charter §3(a)(i)-(iv); Articles §4.1. PwC International promulgates standards and policies that PwC members firm must follow to be able to use the PwC name. Charter §3(a)(i)-(iv); Articles §4.1(E); 2008 Review at 35; PwC International also promulgates auditing standards and methodologies that PwC member firms must follow when conducting their audits. *See e.g.*,2008 Review at 36; Presentation "The PwC Audit" at *http://aaahq.org/audit/midyear/04midyear/papers/The%20PwC%20Audit%20-%20011704%20Presentation.ppt#453,1,The*. Further PwC International had an assurance review program where reviews were conducted over the audits performed by the PwC member

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[42] New York courts have consistently emphasized that an inquiry into the merits of vicarious liability is premature on a motion to dismiss. *See e.g., TeeVee Toons, Inc. v. Gerhard Schubert GMBH*, 2002 WL 498627 (S.D.N.Y. Mar. 29, 2002); *Toppel v. Marriott International, Inc.*, 2006 WL 2466247 (S.D.N.Y. Aug. 24, 2006). As the court in *Parmalat* noted: "[T]he issue here is not whether plaintiffs have proved the existence of an agency relationship, merely whether they should have a chance to do so." *Parmalat*, 375 F. Supp. 2d at 295.

[43] The three cases primarily relied upon by PwC International – *Star Energy Corp. v. RSM Top-Audit*, 2008 WL 5110919 (S.D.N.Y. Nov. 26, 2008), *Nuevo Mundo Holdings v. PricewaterhouseCoopers LLP*, 2004 WL 112948 (S.D.N.Y. Jan 22. 2004), and *In re Lernout & Hauspie Sec. Litig.*, 230 F. Supp. 2d 152 (D. Mass. 2002) – are distinguishable. In *Star Energy*, there was no executive overlap alleged between the principal auditing company and subsidiary and plaintiffs did not adequately allege the audit at issue was subject to the principal's control. *Star Energy*, 2008 WL 5710919, at *4-5. In *Nuevo Mundo Holdings*, plaintiffs were asserting a vicarious relationship between a Peruvian accounting firm and its US affiliate based solely on allegations that they share a common name and the same parent company. *Nuevo Mundo* Holdings, 2004 WL 112948, at *3. In fact, the plaintiffs in *Nuevo Mundo Holdings* failed to allege that the US affiliate had the right to control any aspects of the Peruvian firm's operations. *Id*. at *5. In *In re Lernout*, the plaintiffs relied too heavily on mere advertising slogans, and failed to allege the subsidiaries conducted audits subject to KPMG control or that they used KPMG's name or logo. *In re Lernout*, 230 F. Supp. 2d at 173. Thus, those cases do not support dismissing plaintiffs' claims here.

firms every three years.[44] In addition, PwC International had the right to discipline the PwC member firms and their individual partners when they fail to adhere to the PwC global audit standards. *See e.g.*, Articles, §4.1(B).

PwC International's literature and global website refer to the constituent PwC offices such as PwC Canada and PwC Netherlands simply as "PricewaterhouseCoopers" or as "PwC." (SCAC ¶ 268.) In turn, the constituent firms such a PwC Canada made clear in their audit letters that "PricewaterhouseCoopers refers to the Canadian firm… and other member firms of PricewaterhouseCoopers International Limited." (*Id*. ¶ 270.) Having chosen to portray, market, and conduct itself as the controlling entity of the PwC global network, PwC International cannot now, on a motion to dismiss no less, claim that it is not liable for the conduct of its member firms.

B. The SCAC States a Valid Claim under Section 20(a) of the Exchange Act against PwC International

The SCAC sufficiently alleges a "control person" claim against PwC International for the securities fraud PwC Canada and PwC Netherlands committed. Section 20(a) of the Exchange Act makes a defendant derivatively liable for the securities violations of ***a party*** that it controlled. *See* 15 U.S.C. § 78 t(a). The plain text of the statute sets forth two elements for a §20(a) claim: (1) a primary violation by the controlled person; and (2) control of the primary violator by the Section 20(a) defendant. *Id*. *See also, Pension Comm. of Univ. of Montreal Pension Plan v. Banc of America Sec. LLC*, 446 F. Supp. 2d 163, 190 (S.D.N.Y. 2006). As stated *supra* at Section I, the SCAC pleads primary §10(b) claims against PwC Canada and PwC Netherlands. The SCAC also alleges sufficient facts demonstrating PwC International's control

[44] *See* 2008 Review at 36

of PwC Canada and PwC Netherlands, and moreover, that PwC International was a "culpable participant" in their securities violations. (SCAC ¶¶ 268-274, 292-294.)

As this Court has recognized, a §20(a) claim's allegations as to control are evaluated pursuant to Rule 8(a). *Varghese v. China Shenghuo Pharmaceutical Holdings, Inc.*, 2009 WL 4668579 at *11 (S.D.N.Y. Dec. 9, 2009); *Hall v. The Children's Place Retail Stores, Inc.*, 580 F. Supp. 2d 212, 235 (S.D.N.Y. 2008) (denying motion to dismiss). Moreover, "[w]hether a person is a 'controlling person' is a fact-intensive inquiry, and generally should not be resolved on a motion to dismiss." *Katz v. Image Innovations Holdings, Inc.*, 542 F. Supp. 2d 269, 276 (S.D.N.Y. 2008) (*quoting CompuDyne Corp. v. Shane*, 453 F. Supp. 2d 807, 829 (S.D.N.Y. 2006). *In re Alstom Secs. Litig.*, 406 F. Supp. 2d 433, 487 (S.D.N.Y. 2005) (determining issues of control "involves an individualized, fact-sensitive analysis"). Here, the SCAC sufficiently alleges facts showing that PwC International exercised actual control over PwC Canada and PwC Netherlands in connection with their audits of the Funds. Accordingly, PwC International's motion to dismiss the SCAC's §20(a) claim should be denied.

1. The SCAC Adequately Alleges PwC International's Control

Control is "the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." *See also Parmalat Sec. Litig.*, 594 F. Supp. 2d 444, 456-57 (S.D.N.Y. 2009); *In re Initial Pub. Offering Secs. Litig.*, 241 F. Supp. 2d 281, 393 (S.D.N.Y. 2003); *Alstom,* 406 F. Supp. 2d at 486 (S.D.N.Y. 2005); 17 C.F.R. §240.12b-2 (2003). The plain language of the statute requires that "control" be over the person liable, not the transaction at issue. *See, e.g., Parmalat*, 594 F. Supp. at 456 ("[T]he plain language of Section 20(a), requires control only of a person or entity . . . not of the transaction constituting the violation." "[O]nly the ability to direct the actions of the controlled person and not the active exercise thereof is required to establish control …") (*quoting*

Dietrich v. Bauer, 126 F. Supp. 2d 759, 764-65 (S.D.N.Y. 2001); *CompuDyne Corp. v. Shane*, 453 F. Supp. 2d 807, 829 (S.D.N.Y. 2006) (same).[45]

In *Parmalat*, the court had rejected the argument that an organization for a global accounting firm had to have control "over the transactions in question" and held that the allegations sufficiently alleged "the ability to control the transactions" in any event. *See Parmalat*, 474 F. Supp. 2d at 554. The *Parmalat* court's analysis should be applied here.

The factual allegations and documentary evidence in support of the conclusion that PwC International controlled PwC Canada and PwC Netherlands are set forth in section III.A.1 and need not be repeated. (*See* SCAC ¶¶268-274, 292-294) Charter §3(a)(i)-(iv); Articles §4.1; 2008 Review; *Keeshan Decl*.).

Teacher's Retirement Sys. of Louisiana v. A.C.L.N, Ltd., 2003 WL 21058909 (S.D.N.Y. May 15, 2003), and *Parmalat*, 375 F. Supp. 2d 278, provide guideposts for this Court on this claim. In *Teacher's Retirement Sys. of Louisiana*, the plaintiffs referenced statements in the auditing firm's annual reports that the firm's organization's structure "ensures strict quality control," "sharing of skills and ideas" and "conditions [with] which each member firm has to comply to be part of the BDO network". *Id.* at *12. The court upheld the §20(a) claim, holding that the facts supported a "reasonable inference of control." *Id* at *39; *see also Varghese*, 2009 WL 4668579, at *12 (control alleged based on allegations that defendants had power to "influence and control and did influence and control, directly or indirectly, the decision-making" of the primary actor, and "direct and supervisory involvement"); *Parmalat*, 275 F. Supp.2d at 459 (alleged control by the a global auditing organization over a member firm, predicated upon

[45] *But see Alstom*, 406 F. Supp. 2d at 487 (stating that a control person must "have actual control over the transaction in question") (*quoting In re Global Crossing*, 2005 WL 1875445, at *3 (S.D.N.Y. Aug. 5,

the audit firm's structure, access to books and papers of member firms, the contractual relationships among member firms themselves, and the organization's apparent ability to exert influence over that member firm); *Parmalat*, 594 F. Supp. 2d at 459 (noting overlapping executive positions). Similarly here, the SCAC sufficiently alleges, as supported by PwC International's own documents, that PwC International had the requisite control over PwC Canada and PwC Netherlands to be liable under §20(a). *See* (SCAC ¶¶268-274, 292-294); Charter §3(a)(i)-(iv); Articles §4.1; 2008 Review.

PwC International cites no decision that warrants dismissal of Plaintiffs' §20(a) claim.[46] *In re Asia Pulp & Paper Secs. Litig.*, 293 F. Supp. 2d 391 (S.D.N.Y. 2003), is readily distinguishable because the plaintiffs relied solely on a "one firm theory" and their complaint was "bereft of any allegations" that the auditing firm was able to "in any way influence the particular audits conducted or opinions offered" by the member firms. *Id.* at 396. Likewise, in *CBT Group PLC Secs. Litig.*, 2000 WL 3339615, at *5 (N.D. Cal. Dec. 29, 2000), the complaint alleged merely that the defendant "coordinat[ed] cross-border work" and "develop[ed]" practice standards with no allegation of control over the member firm's operation or management. *Id.* And in *Nuevo Mundo Holdings v. PricewaterhouseCoopers LLP*, 2004 WL 112948 (S.D.N.Y.

2005). *Alstom*, however, did not involve a §20(a) claim against an auditing organization or that organization's control over a member firm.

[46] PwC International's other cases are wholly inapposite and involved §20(a) claims that pleaded nothing more than the defendant's status. *See In re Global Crossing, Ltd. Secs. Litig.*, 2005 WL 1907005 (relying solely on status as minority shareholder); *In re Deutsche Telekom AG Secs. Litig.*, 2002 WL 244597 (S.D.N.Y. Feb. 20, 2005) (same); *H&H Acquisition Corp. v. Financial Intranet Holdings*, 2009 WL 3496829 (S.D.N.Y. Oct. 29, 2009) (same, as an escrow agent); *Rich v. Maidstone Fin., Inc*., 2001 WL 286757 at *9 (S.D.N.Y. Mar. 23, 2001) (same, as wife); *Primavera Familienstiftung v. Askin*, 1996 WL 494904 at *11 (S.D.N.Y. Aug. 30, 1996) (as seller of securities). *See also Owens v. Gafken v. Barriger Fund, LLC*, 2009 WL 3073338, at *12 (claim made the single allegation that defendants were "controlling persons"). Unsurprisingly, where the complaint, as here, did not rely solely on the defendant's status and alleged an ability "to influence the policies and decision-making," the court sustained the §20(a) claim. *See Police and Fire Retirement Sys of City of Detroit v. Safenet, Inc.*, 645 F. Supp. 2d 210, 242 (S.D.N.Y. 2009).

Jan 22, 2004), plaintiffs sought to establish that each member firm should be subject to liability for each other member firm's conduct rather than holding the global network entity liable for its members' conduct.

2. The SCAC Adequately Alleges PwC International's "Culpable Participation"

There is a vigorous debate in the district courts of the Second Circuit whether a plaintiff must plead "culpable participation" as a separate element of a §20(a) claim. *See Parmalat,* 375 F. Supp. 2d at 308; *In re Initial Public Offering Secs. Litig.*, 241 F. Supp. 2d at 395. Plaintiffs respectfully submit that they should not be required to plead culpable participation as an element of control person liability for the reasons set forth in § I.F.2 of Plaintiffs' Consolidated Opposition to the Fairfield Greenwich Defendants' Motion to Dismiss ("FGG Opp. Br."), which are incorporated by reference herein.

Assuming *arguendo* that culpable participation must be pled, the SCAC alleges sufficient facts to demonstrate: (i) PwC International's culpable participation in the primary securities violations by PwC Canada and PwC Netherlands, and (ii) *scienter*. (SCAC ¶¶ 268-274, 293-294.) These allegations sufficiently demonstrate that PwC International's conduct was highly reckless and unreasonable and represented an extreme departure from standards of ordinary care. The Court has made clear that a plaintiff need not use the words "culpable participation: in the Section 20(a) Count of the Complaint." *Alstom*, 406 F. Supp. 2d at 496. *See also id.* (holding that plaintiffs stated a §20(a) claim despite failure to allege "culpable participation" based on facts alleged); *Varghese*, 2009 WL 4668579, at *12 (holding that defendants were alleged culpable participants, based on allegations of control).[47]

[47] In each of the cases PwC International cites in which a §20(a) claim was dismissed based on lack of "culpable participation," the complaints were devoid of ***any*** facts, unlike here (SCAC ¶¶268-274), of even

IV. PLAINTIFFS HAVE STANDING TO ASSERT STATE LAW CLAIMS AGAINST PWC

Plaintiffs have standing to assert the federal securities law claims and state law claims against the PwC for the reasons set forth in the FGG Opp. Br. at § II.C, which are incorporated by reference herein. Contrary to PwC's argument, Plaintiffs' claims are not derivative in nature; in fact, they are textbook examples of direct claims held by investors who relied on misleading statements in making and holding investments. *See, e.g., Primavera Familienstiftung v. Askin*, 130 F. Supp. 2d 450, 495 (S.D.N.Y. 2001) ("Investors may assert a fraud claim based on the theory that they were induced to make and/or retain their investments"); *Jones v. PricewaterhouseCoopers, LLP*, 2004 WL 3140909 (N.Y.S. 2004) ("[D]irect claims, such as fraud in the inducement of their initial investment in the Partnership, …are not derivative"); *Pension Committee*, 446 F. Supp. 2d at 205 (shareholders may bring direct claims based on the theory that they were "induced to make and/or retain their investments.").

V. SLUSA AND THE MARTIN ACT DO NOT BAR PLAINTIFFS' STATE LAW CLAIMS AGAINST PWC

A. SLUSA Does Not Pre-empt Plaintiffs' State Law Claims

Plaintiffs' claims against PwC are not preempted by SLUSA for the reasons set forth in the FGG Opp. Br. at § VI.A,, which are incorporated by reference herein.

B. The Martin Act Does Not Pre-empt Plaintiffs' Claims

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tangential involvement and influence in the primary violations. *Kalin v. Xanboo, Inc.*, 526 F. Supp. 2d 392, 405 (S.D.N.Y. 2007) (culpable participation based solely on alleged existence of one overlapping principal); *Steed Finance LDC v. Laser Advisers, Inc.*, 258 F. Supp. 2d 272 (S.D.N.Y. 2003) (claim was asserted in third-party claim by fund advisors against fund sponsors, plaintiffs had sole responsibility over matters alleged). Others, unlike here (SCAC ¶¶268-274), alleged no facts from which the intention on the part of the defendant could be inferred. *See Edison Fund v. Cogent Invest. Strategies Fund, Ltd.*, 551 F. Supp. 2d 210 (S.D.N.Y. 2008), *In re Sotheby's Holdings, Inc.*, 2000 WL 1234601 (S.D.N.Y. Aug. 31, 2000).

Plaintiffs' claims against PwC are not preempted by the Martin Act for the reasons set forth in the FGG Opp. Br. at § VI.B, which are incorporated by reference herein.

VI. PLAINTIFFS REQUEST LEAVE TO AMEND THE SCAC IF THE COURT GRANTS THE PWC DEFENDANTS' MOTIONS TO DISMISS IN WHOLE OR IN PART

If the Court dismisses any of the claims set forth in the SCAC, Plaintiffs seek leave to amend the SCAC to correct any deficiencies identified by the Court. Leave to amend is granted at the Court's discretion and "shall be freely given when justice so requires." FED. R. CIV. P. 15(a); *see also S.S. Silberblatt, Inc. v. East Harlem Pilot Block*, 608 F.2d 28, 42 (2d Cir. 1979).

CONCLUSION

For the foregoing reasons, Plaintiffs respectfully request that the Court deny the motions to dismiss filed by the PwC Defendants or in the alternative, allow Plaintiffs to amend the SCAC to cure any deficiencies in pleading.

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Respectfully submitted,

By: /s/ David A. Barrett

David Boies
BOIES, SCHILLER & FLEXNER LLP
333 Main Street
Armonk, NY 10504
Telephone: (914) 749-8200
Facsimile: (914) 749-8300

David A. Barrett
Howard L. Vickery, II
BOIES, SCHILLER & FLEXNER LLP
575 Lexington Avenue
New York, NY 10022
Telephone: (212) 446-2300
Facsimile: (212) 446-2350

Stuart H. Singer
Sashi Bach Boruchow
BOIES, SCHILLER & FLEXNER LLP
401 East Las Olas Boulevard, #1200
Ft. Lauderdale, Florida 33301
Telephone: (954) 356-0011
Facsimile: (954) 356-0022

Robert C. Finkel
James A. Harrod
E. Elizabeth Robinson
Natalie M. Mackiel
WOLF POPPER LLP
845 Third Avenue
New York, NY 10022
Telephone: 212.759.4600
Facsimile: 212.486.2093

Christopher Lovell
Victor E. Stewart
LOVELL STEWART HALEBIAN LLP
500 5th Avenue, Suite 5800
New York, NY 10110
212-608-1900

Interim Co-Lead Counsel for Plaintiffs

Of Counsel:

Robert S. Schachter
Hilary Sobel
ZWERLING, SCHACHTER & ZWERLING, LLP
41 Madison Avenue
New York, NY 10010
(212) 223-3900

Counsel for Plaintiffs Nadav and Rohit Zohar

Steven J. Toll
S. Douglas Bunch
COHEN MILSTEIN SELLERS & TOLL PLLC
1100 New York Ave. NW
Suite 500, West Tower
Washington, DC 20005
(202) 408-4600

Jacob Sabo
The Tower
#3 Daniel Frisch St.
Tel Aviv, Israel
011 (972) 3607-8888

Counsel for Plaintiffs Arie and Dafna Gruber, Carling Investment Ltd., Madanes Investment & Enterprise Ltd., and Shimon Laor

Daniel W. Krasner
Gregory M. Nespole
WOLF HALDENSTEIN ADLER FREEMAN & HERZ LLP
270 Madison Avenue
New York, New York 10016
(212) 545-4600

Counsel for Plaintiff The Knight Services Holdings Limited

David A. Gehn
GUSRAE, KAPLAN, BRUNO & NUSBAUM PLLC
120 Wall Street
New York, NY 10005
(212) 269-1400

Counsel for Plaintiff Pacific West Health Medical Center, Inc. Employee's Retirement Trust

Of Counsel:

David A. Gehn
GUSRAE, KAPLAN, BRUNO & NUSBAUM PLLC
120 Wall Street
New York, NY 10005
212-269-1400