UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

ANWAR, *et al.*,	::	
Plaintiffs,	::	
v.	::	
FAIRFIELD GREENWICH LIMITED, *et al.*,	::	MASTER FILE NO. 09-CV-0118 (VM)
Defendants.	::	
This Document Relates To: All Actions	::	

REPLY MEMORANDUM OF LAW IN FURTHER SUPPORT OF THE MOTION TO DISMISS THE SECOND CONSOLIDATED AMENDED COMPLAINT ON BEHALF OF DANIEL LIPTON, MARK MCKEEFRY, WALTER NOEL, ANDRÉS PIEDRAHITA, JEFFREY TUCKER, AMIT VIJAYVERGIYA, FAIRFIELD GREENWICH LIMITED, FAIRFIELD GREENWICH (BERMUDA) LTD., FAIRFIELD GREENWICH ADVISORS LLC, FAIRFIELD RISK SERVICES LTD., AND FAIRFIELD HEATHCLIFF CAPITAL LLC (THE "FG DEFENDANTS")

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PRELIMINARY STATEMENT

In the last five months, eight courts in this district and elsewhere have dismissed Madoff-related claims substantially identical to those asserted here. These claims were dismissed for the same reasons the FG Defendants have moved to dismiss the SCAC. Copies of these decisions are submitted herewith as Appendix A:

- In *Stephenson v. Citco Group Ltd.*, Judge Holwell held that the Martin Act preempted breach of fiduciary duty, gross negligence, and negligence claims arising out of investments in a feeder fund, Greenwich Sentry, one of the funds at issue here;

- In *Meridian Horizon Fund, LP v. Tremont Group Holdings Inc.*, Judge Griesa dismissed securities fraud and common law fraud claims for failure to plead scienter and dismissed negligence claims as preempted by the Martin Act;

- In *In re Tremont Sec. Law, State Law & Ins. Litig*., Judge Griesa dismissed securities fraud and common law fraud claims for failure to plead scienter and dismissed claims for negligent misrepresentation and breach of fiduciary duty as preempted by the Martin Act;

- In *Barron v. Igolnikov*, Judge Griesa held that both the Martin Act and SLUSA preempted claims against a feeder fund for breach of fiduciary duty, gross negligence, and unjust enrichment;

- In *SEC v. Cohmad*, Judge Stanton dismissed a securities fraud claim against a broker-dealer with offices on the actual premises of BMIS;

- In *Backus v. Connecticut Community Bank, N.A.*, Judge Dorsey held that SLUSA preempted plaintiffs' breach of contract claim;

- In *Levinson v. PSCC Servs., Inv.*, Judge Dorsey held that SLUSA preempted fraud, negligent misrepresentation, breach of contract, breach of fiduciary duty, negligence, unjust enrichment, and constructive trust claims; and

- In *CRT v. Merkin*, Justice Lowe III of the Supreme Court of the State of New York held that the Martin Act preempted negligent and gross negligent misrepresentation claims.

Plaintiffs offer no basis grounded in the law as to why this Court should depart from this consistent and growing authority. Rather, the Plaintiffs rely on mis-citations to case law and to the

pleadings in their own complaint to cobble together arguments that are contrary to the governing law. The recent cases and prior authority correctly apply the law dispositive here, as follows:

- Regardless of which state or country's law applies, Plaintiffs lack standing because their injuries are entirely derivative of the injuries suffered by the Funds in which they invested.

- Plaintiffs cannot overcome the authority in this district preempting their claims under the Martin Act and SLUSA. Plaintiffs' contention that preemption is limited only to claims alleging violations of the Martin Act or its implementing regulations is contrary to recent decisions and inconsistent with relevant guidance from the New York Court of Appeals. And Plaintiffs' claim that a sufficient New York nexus does not exist for the Martin Act has rightly been rejected by the courts in other Madoff cases and is internally inconsistent with their choice of law analysis.

- Plaintiffs' argument that SLUSA does not apply because Plaintiffs did not purchase covered securities directly from Madoff conflicts with the Supreme Court's clear directive that SLUSA should be read broadly, a directive courts around the country have followed in analogous cases.

- The exculpatory provisions in the investment management agreements shield the FG Defendants from liability.

- Plaintiffs fail to overcome the fact that far from being partners, the FG companies each were incorporated – a fact disclosed to Plaintiffs. No partnership was either intended or established.

- Plaintiffs have not stated claims under Sections 10(b) and 20(a) of the Exchange Act. Plaintiffs' assertion that the FG Defendants were privy to information that contradicted statements in the offering memoranda is not based on any well pled factual allegations in the SCAC, and their attempt to use self-imposed due diligence standards to prove fraud fails as a matter of law. Plaintiffs also do not allege reasonable reliance or loss causation. The § 20(a) claim similarly fails because Plaintiffs have not pled a primary securities fraud violation or the required elements of control and culpable participation. *See* Reply Brief of the Other Fairfield Defendants, which is incorporated by reference herein.

- Plaintiffs' Opposition does not cure the defects in their common law fraud, negligent misrepresentation, breach of fiduciary duty, and gross negligence claims. Nor does the Opposition salvage Plaintiffs' contract-related claims. *See* Reply Brief of the Fairfield Fee Defendants, which is incorporated by reference herein.

- Plaintiffs' request for punitive damages must be rejected because the SCAC does not come close to alleging that the FG Defendants acted with the requisite high degree of moral culpability. To the contrary, the FG Defendants were victims of the fraud perpetrated by Madoff, and the moral culpability lies with Madoff.

Plaintiffs' Opposition actually underscores the SCAC's deficiencies. Plaintiffs' heavy and improper reliance on unsubstantiated allegations by an unidentified, so-called "Confidential Witness" – who is not referenced even once in the SCAC – is, in essence, an admission of the insufficiency of their pleadings. And the gross overstatements in their brief of the thin facts actually pled in their SCAC also points to the insufficiency of their pleading. Plaintiffs' mischaracterizations of their own pleadings in their SCAC are set forth in Appendix B hereto.

I. PLAINTIFFS LACK STANDING TO BRING THEIR STATE LAW CLAIMS

A. The Law Of The Place Of Incorporation Determines Whether Plaintiffs Have Standing To Bring Claims

Contrary to Plaintiffs' argument, New York courts consistently apply the internal affairs doctrine when determining whether shareholders have standing to bring direct claims.[1] Plaintiffs' allegations plainly concern the internal affairs of the Funds.[2] And contrary to Plaintiffs' assertions, the internal affairs doctrine applies to claims against third parties that "relate[] fundamentally to the conduct of the internal affairs" of the corporation.[3] Because Sentry and Sigma are British Virgin Islands ("BVI") corporations, and GS and GSP are Delaware limited partnerships, BVI and Delaware law govern whether Plaintiffs have standing to bring their claims directly.

B. Plaintiffs Lack Standing To Bring Their Claims Regardless of What Law Applies

1. Plaintiffs Lack Standing Under BVI Law

[1] *Walton v. Morgan Stanley & Co.*, 623 F.2d 796, 798 n.3 (2d Cir. 1980); *Seybold v. Groenink,* No. 06 Civ. 772(DLC), 2007 WL 737502, at *5-6 (S.D.N.Y. Mar. 12, 2007); *In re Goldman Sachs Mut. Funds Fee Litig.*, No. 04 Civ. 2567(NRB), 2006 WL 126772, at *5 n.11 (S.D.N.Y. Jan. 17, 2006).

[2] Plaintiffs allege: (1) Noel served as a director of Sentry and Sigma (SCAC ¶ 124); (2) Noel and Tucker were the General Partners of GS at certain points (SCAC ¶ 406) (3) FGBL was the General Partner of GS at certain points and the General Partner of GSP since that Fund's inception (SCAC ¶ 119); (4) FGL was the General Partner of GS at certain points (SCAC ¶ 118); and (5) the FG Defendants had significant discretion and control over assets in the funds (SCAC ¶ 124-129).

[3] *See BSS Norwalk One, Inc. v. Raccolta, Inc.*, 60 F. Supp. 2d 123, 129 (S.D.N.Y. 1999); *see also Stephenson v. Citco Group Ltd.*, No. 09 Civ. 00716(RJH), 2010 WL 1244007, at *7 (S.D.N.Y. Apr. 1, 2010).

Plaintiffs do not contest that under BVI law, shareholders are barred from pursuing a direct claim where their loss is reflective of the company's loss. Pl. Br. at 67; FG Def. Br. at 12-14; Farara Aff. ¶¶ 7-19. Plaintiffs argue that the reflective loss principle does not apply here because the Funds' claims may differ from theirs. Pl. Br. at 67. Plaintiffs are wrong. The rule against reflective loss applies even where the shareholder and the company have different *claims*, as long as they suffer the same *loss*. Farara Aff. ¶¶ 7-19. Here, the alleged losses are the same: the complete loss of the Funds' investments in Madoff. *Id.*[4] Plaintiffs' claim that the amounts recoverable by the Funds and the shareholders are different is premised on a ruling by Judge Lifland with respect to the payment of SIPA claims, which obviously differs from the measurement of damages available to the Funds in private actions against the FG Defendants. Plaintiffs' argument that the *in pari delicto* defense may bar Sentry and Sigma (collectively, the "Offshore Funds") from recovery fails under BVI law because Plaintiffs improperly conflate the Funds with the management companies being sued here, and because Plaintiffs do not allege that the contracts the Funds would be suing under – the investment management agreements ("IMAs") – were illegal or unenforceable. Farara Aff. ¶¶ 42-48. Contrary to Plaintiffs' assertions, a BVI court would dismiss the Complaint at this stage of the litigation. Farara Aff. ¶¶ 49-52.

2. Plaintiffs Lack Standing Under Both Delaware and New York Law

Under both Delaware and New York law, a shareholder must suffer "an injury separate and distinct from the injury suffered by the Funds" to have standing.[5] Plaintiffs fail to meet this test. They do not complain of separate injury but rather allege harm by Fairfield's alleged failure to conduct adequate due diligence and monitoring of BMIS. Far from helping their argument, such

[4] Indeed, the Sentry Fund, through its Liquidators, has brought a direct lawsuit in New York state court seeking compensatory damages for the same losses alleged by Plaintiffs. *Fairfield Sentry Limited v. Fairfield Greenwich Group*, No. 601687/09 ¶ 6 (N.Y. Sup. Ct. filed May 29, 2009).

[5] *Fraternity Fund Ltd. v. Beacon Hill Asset Mgmt.*, 376 F. Supp. 2d 385, 408 (S.D.N.Y. 2005) (citation omitted); *see also Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1033 (Del. 2004).

claims sound in corporate mismanagement and waste[6] and as such, are derivative in nature.[7] Plaintiffs' argument also fails that they have direct claims against the FG Defendants as "third-party investment advisors" to the Offshore Funds.[8] The cases they cite are inapposite because they involve investors who were advised directly by their own independent investment advisor.[9] Here, the FG Defendants were investment managers of the *Funds*, not investment advisors to the investors, and the SCAC contains no particularized allegations that any specific FG Defendant had direct contact with any Plaintiff.

Plaintiffs' argument that their claims are direct because they are based on misrepresentations that induced them to maintain their investments in the Funds is also wrong.[10] The alleged misrepresentations concern Fairfield's risk management practices. Again, claims for mismanagement are derivative in nature. Recasting such a claim as one for misrepresentation fails. *See, e.g., Crossen v. Bernstein*, No. 91 Civ. 3501(PKL), 1994 WL 281881, at *3 (S.D.N.Y. June 23, 1994); *Goldman Sachs*, 2006 WL 126772, at *6 (applying Delaware law).[11]

3. <u>Plaintiffs Improperly Rely on the *In Pari Delicto* Defense</u>

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[6] *See In re Evergreen Mutual Funds Fee Litig.*, 423 F. Supp. 2d 249, 261 (S.D.N.Y. 2006); *Albert v. Alex. Brown Mgmt. Servs., Inc.*, Nos. Civ. A. 762-N, 763-N, 2005 WL 2130607, at *13 (Del. Ch. Aug. 26, 2005).

[7] *See Primavera Familienstifung v. Askin*, 130 F. Supp. 2d 450, 494 n.37 (S.D.N.Y. 2001), *amended in part by* 137 F. Supp. 2d 438 (S.D.N.Y. 2001); *Jones v. PricewaterhouseCoopers, LLP*, No. 602962/06, 2004 WL 3140909, at *4 (N.Y. Sup. Ct. Nov. 5, 2004).

[8] Plaintiffs argue incorrectly that the LPAs confer standing to directly pursue breach of fiduciary duty claims. Pl. Br. at 64 n.61. Standing is a constitutional requirement that cannot be conferred by contract. *Primavera Familienstiftung v. Askin*, No. 95 Civ. 8905(RWS), 1996 WL 494904, at *12 (S.D.N.Y. Aug. 30, 1996).

[9] *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 41 (2d Cir. 1978); *Rasmussen v. A.C.T. Envtl. Servs. Inc.*, 739 N.Y.S.2d 220, 222 (App. Div. 2002). Moreover, a fund's investment adviser owes fiduciary duties only to the fund, not to its investors. *See Goldstein v. SEC*, 451 F.3d 873, 880-81 (D.C. Cir. 2006).

[10] Plaintiffs incorrectly state that the FG Defendants do not contest that Plaintiffs have standing to pursue fraudulent and negligent misrepresentation claims. *See* FG Def. Br. at 17-18.

[11] *See also San Diego County Employees Retirement Assoc. v. Maounis*, No. 07 Civ. 2618(DAB), 2010 WL 1010012, at *20 (S.D.N.Y. Mar. 15, 2010) (citation omitted); *Aboushanab v. Janay*, No. 06 Civ. 13472(AKH), 2007 WL 2789511, at *6 (S.D.N.Y. Sept. 26, 2007); *Lee v. Marsh & McLennan Cos.*, No. 009717/06, 2007 WL 4303514, at *5-6 (N.Y. Sup. Ct. Dec. 7, 2007).

Plaintiffs' reliance on *in pari delicto* (the *Wagoner* rule) as a basis for standing is misguided. Pl. Br. at 65-66. The *Wagoner* rule prohibits a bankruptcy trustee from suing third parties for injuries to the debtor corporation where the corporation would have been barred from bringing such a claim by virtue of its involvement in the wrongdoing. *Shearson Lehman Hutton, Inc. v. Wagoner*, 944 F.2d 114, 118 (2d Cir. 1991). It does not provide an independent basis for shareholder standing. *Id.* *See, e.g.*, *ABF Capital Mgmt. v. Askin Capital Mgmt., L.P.*, 957 F. Supp. 1308, 1333-34 (S.D.N.Y. 1997); *Primavera Familienstiftung v. Askin*, No. 95 Civ. 8905(RWS), 1996 WL 494904, at *12 (S.D.N.Y. Aug. 30, 1996).[12]

II. THE MARTIN ACT PREEMPTS THE NON-FRAUD COMMON LAW CLAIMS

A. Recent Decisions Confirm Martin Act Preemption of Plaintiffs' Claims

The overwhelming majority of New York state and federal court decisions hold that Martin Act preemption applies in analogous circumstances (*see* FG Def. Br. at 18-20).[13] Plaintiffs' claim that the more recent authority goes the other way is plainly wrong. Since the filing of the motions to dismiss, five additional decisions in federal and state courts have been rendered in Madoff-related cases holding that the Martin Act preempts Plaintiffs' non-fraud common law claims here. *See* cases attached in Appendix A.

Stephenson v. Citco Group Ltd., No. 09 Civ. 00716(RJH), 2010 WL 1244007 (S.D.N.Y. Apr. 1, 2010) is particularly instructive. There, as here, plaintiff asserted claims for losses in his

[12] Plaintiffs argue that where a trustee lacks standing, it 'accrues to the creditors" (Pl. Br. at 65), but Plaintiffs are *equity* investors, not creditors. In *Hirsch v. Arthur Andersen & Co.*, the Second Circuit held that a bankruptcy trustee does not have standing to pursue claims that can be pursued by shareholders as direct claims, but here the shareholders and limited partners do not have standing to bring direct claims. 72 F.3d 1085, 1093-94 (2d Cir. 1995); *see also Stephenson v. Citco Group Ltd.*, No. 09 CV 00716 (RJH), 2010 WL 1244007, *8 (S.D.N.Y Apr. 1, 2010) (finding that *Hirsch* did not support argument that limited partner had standing to pursue claims properly belonging to Greenwich Sentry).

[13] Plaintiffs instead rely on a small minority of cases that have not been followed in recent cases. *See Pro Bono Invs., Inc. v. Gerry*, No. 03 Civ. 4347(JGK), 2005 WL 2429787, at *16 (S.D.N.Y. Sept. 30, 2005) (*Cromer* and *Scalp & Blade* "'stand as solitary islands in a stream of contrary opinion'") (quotations omitted); *Joffee v. Lehman Bros., Inc.*, No. 04 Civ. 3507(RWS), 2005 WL 1492101, at *13 (S.D.N.Y. June 23, 2005) (same).

investment in Greenwich Sentry which invested in BMIS and alleged that defendants failed to carry out their duties and investigate purported "red flags" that should have alerted them to Madoff's fraud. *Id.* at *5-6. Judge Holwell dismissed the claims for, *inter alia*, breach of fiduciary duty and gross negligence based on Martin Act preemption, joining the "multitude of courts [that] have dismissed claims materially similar" to those asserted here. *Id.* at *12, 15 (citations omitted).

In the Tremont feeder fund cases, Judge Griesa similarly held that the Martin Act preempts non-fraud claims arising out of investment funds' losses in BMIS. The court noted that "the Second Circuit has adopted the First Department's rule that the Martin Act preempts common law tort claims in the securities context."[14] And just this month, State Supreme Court Justice Lowe held that the Martin Act preempted negligent misrepresentation claims against a general partner and investment manager of funds invested in Madoff. *See CRT v. Merkin*, No. 601052/09, slip op. at 10 (N.Y. Sup. Ct. May 5, 2010).[15]

B. Martin Act Preemption is Not Limited to Causes of Action Pleading Violations of Martin Act Regulations

Plaintiffs' attempt to limit preemption only to claims alleging a violation of the Act or its implementing regulations has been rejected. *See Stephenson v. Citco Group Ltd.*, No. 09 Civ. 00716(RJH), 2010 WL 1244007, at *12-13 (S.D.N.Y. Apr. 1, 2010). Also wrong is Plaintiffs' representation that no New York Court of Appeals decision supports preemption. In *CPC Int'l Inc. v. McKesson Corp.*, 519 N.Y.S.2d 804 (N.Y. 1987), the Court of Appeals held that there is no implied private right of action under Act because it would be inconsistent with the legislative

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[14] *See Meridian Horizon Fund, LP v. Tremont Group Holdings, Inc.*, No. 09 Civ. 3708(TPG), 2010 WL 1257567, *8 (S.D.N.Y. Mar. 31, 2010) (citation omitted) (noting that complaint was centered on allegations of misrepresentations and omissions with respect to the diligence performed on the funds) (negligence); *In re Tremont Sec. Law, State Law & Ins. Litig.*, 08 Civ. 11117(TPG), 2010 WL 1257580 (S.D.N.Y. Mar. 30, 2010) (breach of fiduciary duty, aiding and abetting breach of fiduciary duty, and negligent misrepresentation).

[15] *See also Barron v. Igolnikov*, No. 09 Civ. 4471(TPG), 2010 WL 882890 (S.D.N.Y. Mar. 10, 2010) (breach of fiduciary duty, gross negligence, and unjust enrichment). As here, the core of the complaints was "that defendants failed to perform adequate due diligence before investing the [funds'] assets with Madoff." *Id.* at *6.

scheme providing the Attorney-General with broad regulatory and remedial powers to prevent fraudulent securities practices. *Id.* at 807. In light of that clear directive, the majority of New York state and federal courts appropriately have determined that Martin Act preemption applies to non-fraud common law causes of action because to hold otherwise '"would effectively permit a private claim under the Martin Act."' *Castellano v. Young & Rubicam Inc.*, 257 F.3d 171, 190 (2d Cir. 2001); *see also Kassover v. UBS AG*, 619 F. Supp. 2d 28, 39 (S.D.N.Y. 2008).[16]

Plaintiffs misstate the holding in *Kerusa Co. v. W10Z/515 Real Estate Ltd. P'ship*, 12 N.Y.3d 236 (N.Y. 2009), in which the Court of Appeals held that the Martin Act preempts common law ***fraud*** claims where the fraud is based solely on alleged violations of the Attorney General's implementing regulations in light of § 352-e of the Act. *Id.* at 243-45. The court did not address preemption under § 352-c, the provision applicable here. In fact, Judge Holwell recently held "[t]he reasoning of *Kerusa* ***supports*** the traditional application of preemption to claims that are covered by § 352-c of the Martin Act." *Stephenson v. Citco Group Ltd.*, No. 09 Civ. 00716(RJH), 2010 WL 1244007, at *13 (S.D.N.Y. Apr. 1, 2010) (emphasis added).[17]

C. The Martin Act's Geographic Prong is Satisfied

Plaintiffs try to avoid Martin Act preemption by arguing that the shares in the Funds were not "primarily" sold within or from New York and some plaintiffs may have interacted with the FG Defendants exclusively outside New York. But Plaintiffs misconstrue the legal test, which requires only that a substantial portion of the events giving rise to the claim occurred in New York.

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[16] Similarly off the mark is Plaintiffs' reliance on *N.Y. Univ. v. Ariel Fund, Ltd.*, No. 603803/08 (N.Y. Sup. Ct. Feb. 22, 2010). *See* Pl. Br. at 98 n.83. There, the court awarded attorneys' fees to NYU after it discontinued its derivative action to allow it to be "subsumed by the AG's action." Slip op. at 5. The award was based on the determination that NYU, in having pursued derivative claims on behalf of the fund, conferred a "substantial benefit" to the fund and its investors, and *not*, as Plaintiffs suggest, on any notion that a private right of action would deter securities fraud and should not be preempted. Slip op. at 9.

[17] Furthermore, in *Vermeer Owners, Inc. v. Guterman*, 578 N.Y.S.2d 128 (N.Y. 1991), the Court of Appeals extended its reasoning in *McKesson*, holding that there is no private right of action under Section 352-e of the Martin Act. *Id.* at 129.

See FG Def. Br. at 19 n.22; *see also Ashland Inc. v. Morgan Stanley & Co.*, No. 09 Civ. 5415(RPP), 2010 WL 1253932, at *16 (S.D.N.Y. Mar. 30, 2010). That test is easily met here because (i) the FG entity defendants had offices and were registered to do business in New York; (ii) a majority of the FG individual defendants were residents or based out of New York; (iii) partnership and equity interests were sold from and to investors in New York; (iv) offering and other fund-related materials were disseminated from New York; and, not least important, (v) Madoff's fraud was perpetrated from New York.[18] *Cf. Meridian Horizon*, No., 2010 WL 1257567, at *8; *Barron*, 2010 WL 882890 at *6. On these facts, the court in *Stephenson* ruled that the Martin Act geographic nexus is met with respect to one of the Funds, Greenwich Sentry. 2010 WL 1244007, at *14-15. Plaintiffs' own allegations that venue is proper in New York and that their claims arise under New York law further support preemption.[19] Finally, the fact that the New York AG has brought claims under the Martin Act against another feeder fund actually "highlights the appropriateness of Martin Act-preemption here." *Meridian Horizon*, 2010 WL 1257567, at *8.

III. SLUSA PREEMPTS PLAINTIFFS' STATE LAW CLAIMS

A. SLUSA Does Not Require Direct Purchases of Covered Securities By Plaintiffs

Plaintiffs concede that the "equity securities" the Funds purchased through BMIS are "covered securities" under SLUSA. Pl. Br. at 86. The fact that Plaintiffs did not purchase those securities directly is irrelevant. The Supreme Court has held that SLUSA preemption applies where "the fraud alleged 'coincides' with a securities transaction-whether by the plaintiff *or by someone else*." *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 85 (2006)

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[18] *See* SCAC ¶¶ 118, 120, 122, 125, 126, 128, 129, 132-134, 136-138, 140, 142, 143, 146, 172, 173.

[19] SCAC ¶ 7; Pl. Br. at 46-49. *See Ashland*, 2010 WL 1253932 at *17; *Sedona Corp. v. Ladenburg Thalmann & Co.*, No. 03 Civ. 3120(LTS)(THK), 2005 WL 1902780, at *22 (S.D.N.Y. Aug. 9, 2005).

(emphasis added). Courts following that directive have applied SLUSA in cases where plaintiffs were not the direct purchasers.[20]

The holdings of two recent Madoff cases are directly applicable here. In *Barron*, the court held that "the securities transaction need not have been performed by plaintiff" in order for SLUSA to apply and concluded that the "covered securities" requirement was satisfied where plaintiffs "purchased limited partnership interests in the UBP Funds – which in turn invested in covered securities – rather than covered securities directly from Madoff." 2010 WL 882890 at *5. In *Backus v. Conn. Cmty. Bank, N.A.*, No. 3:09-CV-1256, 2009 WL 5184360, at *5 (D. Conn. Dec. 23, 2009), the court held that SLUSA applied where plaintiffs invested in the defendant Bank, which in turn invested in Madoff, because the "covered securities" were those "represented to be bought, sold, and held by the BLM 1 and 2 entities."

B. The "In Connection With" Element is Satisfied

The "in connection with" element is satisfied here because "the fraud alleged 'coincide[s]' with [the] securities transaction." *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 85 (2006). Here, the crux of the SCAC is that Fairfield misrepresented the diligence and monitoring it was performing to confirm that Madoff was, in fact, purchasing covered securities. *See* FG Def. Br. at 24. As recent cases demonstrate, this is sufficient to establish the "in connection with" element. *See, e.g.*, *Backus*, 2009 WL 5184360, at *8 (bank's alleged misrepresentations concerning the value of securities invested with Madoff "not only coincide[d] with, but center[ed] on, the purchase and sale of securities"); *see also Levinson v. PSCC Servs.,*

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[20] *See, e.g.*, *Siepel v. Bank of Am.*, 526 F.3d 1122, 1127 (8th Cir. 2008); *U.S. Mortgage, Inc. v. Saxton*, 494 F.3d 833, 844-45 (9th Cir. 2007), *abrogated on other grounds as recognized in Proctor v. Vishay Intertech. Inc.*, 584 F.3d 1208, 1220 n.8 (9th Cir. 2009); *Sullivan v. Holland & Knight LLP*, No. 8:09-CV-531-T-17AEP, 2010 WL 1558553, at *6 (M.D. Fla. Mar. 31, 2010); *Horattas v. Citigroup Fin. Mkts. Inc.*, 532 F. Supp. 2d 891, 903 (W.D. Mich. 2007); *Falkowski v. Imation Corp.*, 309 F.3d 1123, 1129 (9th Cir. 2002); *In re WorldCom, Inc.*, 263 F. Supp. 2d 745, 753-54, 769 (S.D.N.Y. 2003).

Inc., No. 3:09-CV-00269(PCD), 2009 WL 5184363, at *11-12 (D. Conn. Dec. 23, 2009); *Sullivan v. Holland & Knight LLP*, No. 8:09-CV-531-T-17AEP, 2010 WL 1558553, at *3-4, *6 (M.D. Fla. Mar. 31, 2010) (SLUSA barred claims where complaint centered on alleged failure to "do adequate due diligence").[21]

The "in connection with" requirement also is satisfied here because the "nature of the parties' relationship…necessarily involved the purchase and sale of securities." *Levinson*, 2009 WL 5184363, at *11 (holding this requirement satisfied where the parties' agreement "authorized the custodians to transmit Plaintiffs' funds to BLMIS for investment"); *see also Dommert v. Raymond James Fin. Servs., Inc.*, No. Civ. A. 1:06-cv-102, 2007 WL 1018234, at *11-12 (E.D. Tex. Mar. 29, 2007) (SLUSA preempted claims against investment manager because the parties' agreement specified that defendant would utilize and expand upon plaintiff's assets and "[t]he very reason that the parties entered into that Agreement was for the 'purchase or sale of securities.'"). Here, the PPMs explicitly state that the Funds' objective is to "seek to obtain capital appreciation" through the SSC strategy. *See, e.g.*, 8/14/06 Sentry PPM (Ex. 1) at 9 (Unless otherwise noted, "Ex. __" refers to exhibits attached to the December 22, 2009 Declaration of Michael Thorne).[22]

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[21] Plaintiffs incorrectly assert that in *Backus* and *Levinson* there were no separate independently managed entities like the Funds here. Pl. Br. at 92. In both cases plaintiffs alleged that PSCC, a firm providing retirement fund investment consulting services, advised plaintiffs to invest in BLMIS-managed funds, *Backus*, 2009 WL 5184360, at *1; *Levinson*, 2009 WL 5184363, at *1, and that PSCC, together with defendant banks, made false statements. *Levinson*, 2009 WL 5184363, at *1, *4. *Barron*, *Backus*, and *Levinson* are the only decisions to address SLUSA preemption in the context of Madoff-related lawsuits, and all find that preemption applies. And in *Pension Comm. of the Univ. of Montreal Pension Plan v. Banc of Am. Sec., LLC*, No. 05 Civ. 9016(SAS), 2010 WL 546964 (S.D.N.Y. Feb. 16, 2010), on which Plaintiffs rely (*see* Pl. Br. at 91 n.80; 92-93), the court expressly distinguished the Madoff situation, noting that the plaintiffs in *Backus* invested in an intermediate investment vehicle "for the purpose of purchasing covered securities." *Id.* at *3 n.27. The court reasoned that "[u]nlike *Backus* . . . the covered securities are not 'at the heart' of this case." *Id.*

[22] Plaintiffs' reliance on the "Delaware carve-out" is misplaced. The carve-out by its terms is inapplicable to any claim other than the breach of fiduciary duty claim. 15 U.S.C. § 78bb(f). And as to that claim, the carve-out is inapplicable because it requires that the shares at issue be sold *exclusively* to *current* shareholders of the issuer, which is not the case here. 15 U.S.C. § 78bb(f)(3)(A)(ii)(I) (2000); *see also Burekovitch v. Hertz*, No. 01-CV-1277(ILG), 2001 WL 984942, at *6 (E.D.N.Y. July 24, 2001); *G.F. Thomas Invs., L.P. v. Cleco Corp.*, 317 F. Supp. 2d 673, 681-85 (W.D. La. 2004) ("[O]nly when shares of stock are purchased or sold to a limited market (that of the corporation's current shareholders) will the Delaware carve-out provision apply.")

IV. THE EXCULPATORY PROVISIONS IN THE INVESTMENT MANAGEMENT AGREEMENTS BAR CLAIMS BY SENTRY AND SIGMA PLAINTIFFS

The exculpatory provisions in the IMAs bar the claims brought by Plaintiffs who invested in the Offshore Funds. *See* FG Def. Br. at 24-26. Plaintiffs concede that under Bermuda law, these provisions bar all claims other than those based on willful misconduct, bad faith, or reckless disregard. Pl. Br. at 79. Because, contrary to the rhetoric in Plaintiffs' brief, the SCAC does not allege such misconduct, all of Plaintiffs' claims are barred as a matter of Bermuda law. Supplemental Affidavit of Rod Attride-Stirling ("Attride-Stirling Aff.") ¶¶ 65, 67.

Plaintiffs' argument that the exculpatory provisions are inapplicable to claims that are "independent of the contract between the Funds and FGBL" (Pl. Br. at 81) is wrong because, as discussed *supra*, all of Plaintiffs' claims belong to the Funds. Nor can Plaintiffs assert that these provisions do not apply because the FG Defendants owed them a separate duty. The SCAC fails to establish any such duty under Bermuda law. Attride-Stirling Aff. ¶ 22. Finally, the argument that the Bermuda Supply Services Act ("SoSA") "invalidates" the exculpatory provisions is unavailing. Pl. Br. at 79. SoSA does not prohibit the parties to a contract from limiting liability for a breach of its terms, whether express or implied. Attride-Stirling Aff. ¶¶ 56-59.[23]

V. PLAINTIFFS FAIL PROPERLY TO ALLEGE THAT EACH FG DEFENDANT WAS PART OF A PARTNERSHIP

The Opposition does not remedy the SCAC's failure properly to allege that each FG Defendant was part of a partnership – real or de facto.[24] Plaintiffs do not identify any agreement indicating the FG Defendants intended to be partners. To the contrary, the FG Defendants' intention *not* to form a partnership is evidenced by the distinct corporate status held by each of the

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[23] By their terms, the exculpatory provisions apply to FGBL and to the individual FG Defendants as directors and officers of FGBL. To the extent other FG Defendant entities were agents of FGBL, they also are protected. Attride-Stirling Aff. ¶ 60.

[24] The Opposition does not argue "partnership by estoppel" and thus that theory is not addressed herein, but is discussed in the FG Defendants' opening brief (*see* FG Def. Br. at 28).

entity FG Defendants. *See* SCAC ¶¶ 118-121; *see* FG Def. Br. at 26-27. And the offering memoranda indisputably provided notice of the entity FG Defendants' corporate form.[25] Also, as Plaintiffs concede, the PPMs clearly disclosed that the individual FG Defendants held director or officer positions. Pl. Br. at 77; *see also* 12/01/08 Sigma PPM (Ex. 2) at 5-8 & Form ADV Part II.

Plaintiffs attempt to draw attention from their failure to plead a partnership by arguing that Fairfield Greenwich Group ("FGG") is a legal entity that can be sued. Even setting aside the fact that FGG was only a marketing name (*see* FG Def. Br. at 1 n.1), this would not absolve Plaintiffs of their obligation to plead facts that show FGG operated as a partnership and that each FG Defendant was a partner. The application of the factors New York courts consider in testing for the existence of a partnership confirms that the FG Defendants were not partners.[26]

VI. PLAINTIFFS FAIL TO SAVE THEIR FEDERAL SECURITIES FRAUD CLAIMS

Plaintiffs have sued the FG Defendants for securities fraud without alleging that they knew, or even suspected, that Madoff was a fraud. *See* Pl. Br. at 1 ("The Defendants are not being sued for their purported ignorance in not knowing Madoff was himself the world's biggest fraudster."). This is counterintuitive and contrary to recent authority in this district. *See SEC v. Cohmad Sec. Corp.*, No. 09 Civ. 5680(LLS), 2010 WL 363844, at *1 (S.D.N.Y. Feb. 2, 2010) ("[T]he complaint does not allege statements or omissions by defendants that are fraudulent absent awareness or

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[25] The Opposition's reliance on marketing materials is inappropriate. Plaintiffs do not contest that the offering memoranda were the only documents on which they properly could rely. *See* FG Def. Br. at 29.

[26] Plaintiffs do not adequately address these factors. First, they point to no facts suggesting that the FG Defendants shared in losses, which alone is fatal to Plaintiffs' claim. *See* FG Def. Br. at 27-28. Second, the assertion that the FG Defendants jointly controlled the management of the business is undermined by allegations in the SCAC (*see* ¶¶ 118-129) and disclosures in the offering memoranda, which clearly delineate the different *corporate* functions and *corporate* positions held by each FG Defendant. 12/01/08 Sigma PPM (Ex. 2) at 5-8 & Form ADV Part II. Third, Plaintiffs have not pointed to any facts showing that the FG Defendants contributed property or financial resources to FGG. A partnership cannot be inferred from the mere fact that the individual FG Defendants used their skills and knowledge in working for incorporated FG companies. Fourth, Plaintiffs have not alleged that the FG Defendants intended to form a legal partnership.

notice that Madoff's investment advisory business was a sham.").[27] Moreover, nothing in the Opposition cures Plaintiffs' failure to plead scienter, justifiable reliance, and proximate causation – each a required element of Section 10(b) claim liability.

A. Plaintiffs Have Not Pled Scienter

1. Plaintiffs' Motive Allegations are Insufficient and Undermined by the FG Defendants' Personal Investments in Madoff

The FG Defendants' purported earnings of large fees for their work with the Funds, even if true,[28] does not establish motive. "To accept a generalized allegation of motive based on a desire to continue to obtain management fees would read the scienter requirement out of the statute." *Edison Fund v. Cogent Inv. Strategies Fund, Ltd.*, 551 F. Supp. 2d 210, 227 (S.D.N.Y. 2008) (allegation of "extraordinarily high management fees" insufficient to plead motive). Further, the fact that five of the six individual FG Defendants had personal assets at stake with Madoff and all the FG Defendants had their reputations on the line – facts Plaintiffs completely ignore – is fatal to Plaintiffs' motive allegations. *See* FG Def. MTD at 31-32.[29]

2. Plaintiffs Do Not Plead Conscious Misbehavior or Recklessness

a. Plaintiffs Cannot Use the FG Defendants' Self-Imposed Due Diligence and Monitoring Standards to Prove Fraud

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[27] *Meridian Horizon Fund, LP v. Tremont Group Holdings, Inc.*, No. 09 Civ. 3708(TPG), 2010 WL 1257567, at *6 (S.D.N.Y. Mar. 31, 2010); *see also Stephenson v. Citco Group Ltd.*, No. 09 Civ. 00716(RJH), 2010 WL 1244007, at *1 (S.D.N.Y. Apr. 1, 2010); *cf. In re Bayou Hedge Fund Litig.*, 534 F. Supp. 2d 405, 417 (S.D.N.Y. 2007), *aff'd*, *S. Cherry St., LLC v. Hennessee Group LLC*, 573 F.3d 98 (2d Cir. 2009).

[28] Plaintiffs do not allege in the SCAC that the fees were excessive as compared to other hedge fund managers, which they were not. In any event, such an allegation would be insufficient to plead motive. *Cf. In re JP Morgan Chase Sec. Litig.*, 363 F. Supp. 2d 595, 602 (S.D.N.Y. 2005). Plaintiffs' contention in their brief that the Fairfield defendants lacked the management experience to justify their fees is contradicted by their allegations in the SCAC. *See, e.g.* SCAC ¶¶ 124-129.

[29] *See also Plumbers & Steamfitters Local 773 Pension Fund v. Canadian Imperial Bank of Commerce*, No. 08 Civ. 8143(WHP), 2010 WL 961596, at *9 (S.D.N.Y. Mar. 17, 2010); *Zucker v. Sasaki*, 963 F. Supp. 301, 310 n.12 (S.D.N.Y. 1997).

The assertion that an inference of scienter can be "drawn from the allegations concerning specific representations of undertakings made in the PPMs" is wrong. Pl. Br. at 26. In *Bayou*, Judge McMahon held that "[t]he allegation that Hennessee Group promised to conduct a uniquely comprehensive brand of due diligence but failed to do so is insufficient to establish the requisite strong inference of conscious recklessness," and the Second Circuit affirmed. *In re Bayou Hedge Fund Litig.*, 534 F. Supp. 2d at 416, *aff'd*, *S. Cherry St., LLC*, 573 F.3d at 112.[30] Plaintiffs' attempt to distinguish *Bayou* is unavailing. The fact that the defendant in *Bayou* lacked its own fund, made other investment recommendations, and highlighted its due diligence process in a marketing brochure rather than in a PPM were not bases for the broad holding that self-imposed due diligence standards cannot be used to prove fraud. And contrary to Plaintiffs' assertions, plaintiffs in that case did allege red flags, *South Cherry*, 573 F.3d at 112, and the defendant's representations about its due diligence process were assumed to be specific. *In re Bayou Hedge Fund Litig.*, 534 F. Supp. 2d at 416.[31]

Plaintiffs do not cite a single post-PSLRA case where a defendant's self-imposed due diligence standards were sufficient to prove fraud. The reasons not to allow that are manifold. First, it violates public policy and is "unfair to use professionals' self-imposed standards, which may exceed industry standards, against them to try to prove fraud." *In re Bayou Hedge Fund Litig.*, 534 F. Supp. 2d at 416 (internal quotation marks and citation omitted). Second, the failure to perform promised due diligence is a contract issue, not securities fraud. *Cf. S. Cherry St.,* 573

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[30] Even a failure "to perform due diligence commensurate with industry standards is inadequate to plead scienter." *In re Bayou Hedge Fund Litig.*, 534 F. Supp. 2d at 416.

[31] While the district court addressed only whether the defendant's representations about its due diligence were actionable, the Second Circuit went further and rejected the theory that the defendant could be liable "when it represented, among other things, the performance history, investment strategy, principals' track record and auditors' identity for Bayou Accredited and its predecessor fund on the basis of thorough due diligence HG claimed to have performed, but did not." *S. Cherry*, 573 F.3d at 112 (emphasis omitted).

F.3d at 115.[32] Finally, the claim that a defendant failed to perform adequate due diligence is virtually indistinguishable from the claim that the defendant failed to exercise appropriate risk management practices, which has been rejected as a basis for pleading securities fraud.[33]

b. The SCAC Does Not Allege the FG Defendants Had Information Contradicting Statements Made in the PPMs

Plaintiffs' primary argument on scienter – that the FG Defendants had information that contradicted statements made in the PPMs – is a fiction without support in the SCAC. First, with respect to representations about strategy and performance, the SCAC does not point to a single document or any other source to which the FG Defendants had access that revealed Madoff was not executing the SSC strategy or that performance figures for the SSC Funds were inaccurate.[34] Instead, Plaintiffs allege in entirely conclusory terms that Fairfield had "no independent factual basis about the Funds' investment strategy" and that it did not "verify independently" the SSC Funds' returns. SCAC ¶¶ 186, 189. Even if these allegations were true (and they are not), they would be insufficient to plead scienter. *Cf. S. Cherry*, 573 F.3d at 112 (scienter not alleged where complaint was "replete with allegations that HG 'would' have learned the truth as to those aspects of the Bayou funds if HG had performed the 'due diligence' it promised."); *see also Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital, Inc.*, 531 F.3d 190, 196 (2d Cir. 2008).[35]

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[32] The prospective language used to describe the alleged fraud underscores the contractual nature of Plaintiffs' case. *See, e.g.*, SCAC ¶ 355. Indeed, Plaintiffs have brought a contract claim based on the same allegations. *See* SCAC ¶¶ 410-416.

[33] *See, e.g.*, *In re Citigroup, Inc. Sec. Litig.*, 330 F. Supp. 2d 367, 377 (S.D.N.Y. 2004); *Estate of Detwiler v. Offenbecher*, 728 F. Supp. 103, 143 (S.D.N.Y. 1989).

[34] The reference in the SCAC to an unidentified *New York Times*' article about Société Générale's decision not to invest is nowhere near specific enough to constitute contradictory information, and there is no allegation that the FG Defendants ever spoke with anyone at Société Générale about BMIS. *Cf. In re PXRE Group, Ltd., Sec. Litig.*, 600 F. Supp. 2d 510, 541 (declining to infer recklessness based on actions of peer firms), *aff'd*, *Condra v. PXRE Group Ltd.*, 357 F. App'x 393 (2d Cir. 2009).

[35] *See also Ashland*, 2010 WL 1253932, at *12; *Plumbers*, 2010 WL 961596, at *9; *In re Loral Space & Commc'ns Ltd. Sec. Litig.*, No. 01 Civ. 4388(JGK), 2004 WL 376442, at *12 (S.D.N.Y. Feb. 27, 2004); *In re Keyspan Corp. Sec. Litig.*, 383 F. Supp. 2d 358, 387 (E.D.N.Y. 2003).

Second, with respect to statements in the PPMs about Fairfield's due diligence standards and monitoring efforts, those statements cannot be used to prove fraud for the reasons discussed *supra*. Moreover, Plaintiffs do not, as they must, point to concrete evidence showing that they failed to perform a specific claimed diligence or monitoring function. Instead, Plaintiffs ask the court to infer that the FG Defendants did not perform satisfactory due diligence because if they "had actually done the work they said they performed, they would have discovered Madoff's scheme." Pl. Br. at 19. But this is the very sort of circular hypothetical that courts in this district have held to be insufficient to allege scienter. *See, e.g.*, *Ellington Mgmt. Group, LLC v. Ameriquest Mortgage Co.*, No. 09 Civ. 0416(JSR), 2009 WL 3170102, at *3 (S.D.N.Y. Sept. 29, 2009).

Further, the SCAC reflects a number of diligence and monitoring steps undertaken by the FG Defendants, consistent with Fairfield's representations. *See, e.g.*, SCAC ¶ 213 (Tucker went to Madoff's offices to confirm that Madoff was actually making trades); ¶ 223 (Fairfield received trade ticket confirmations from BMIS);[36] ¶ 230 ("Noel, Tucker, McKeefry and Vijayvergiya (by telephone) attended a due diligence meeting at BMIS with Madoff and DiPascali"); ¶ 271 (Lipton was informed of PwC's meeting with Madoff).[37]

The three emails alluded to by Plaintiffs as purported evidence of the FG Defendants' mental state actually compel the conclusion that they never intended to defraud Plaintiffs. Pl. Br. at 30. The statement, the "biggest single counterparty risk we have at FGG is BLM" (SCAC ¶

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[36] This allegation is of course completely inconsistent with Plaintiffs' assertion in their brief that Fairfield did not examine Madoff's trading records. Pl. Br. at 20.

[37] Some of the statements with respect to which Plaintiffs contend the FG Defendants had contradictory information are impermissibly drawn from materials external to the offering documents. *See, e.g.*, SCAC ¶ 201; Pl. Br. at 10 (statements about checking for a reputable auditor contained in document entitled "Investment Process and Risk Management Overview"). Plaintiffs cannot allege reliance on them as a matter of law. Moreover, documents like the Risk Management Overview were used solely to market Fairfield's *non-Madoff* directed Funds and in fact contain no references to Madoff. FG Def. Br. at 45-47. Plaintiffs' assertion that the Risk Management Overview contained a misstatement about Madoff's auditor is false.

206), was included in an email summarizing a risk strategy session, and followed by a proposal to "more formally study" the issue, including undertaking a "comprehensive Risk Group assessment." The email plainly does not show the FG Defendants "deliberately shutting [their] eyes to the facts." *Hart v. Internet Wire, Inc.*, 145 F. Supp. 2d 360, 365 (S.D.N.Y. 2001). To the contrary, the email clearly evidences risk management practices undertaken by Fairfield.

Nor can conscious recklessness be inferred from a request for "clarity from BLM on how he sees the markets and liquidity from his counterparties on the options" (SCAC ¶ 208) or the suggestion about approaching Madoff with "well thought out, reasoned questions that focus on filling the gaps in our knowledge" (SCAC ¶ 209). To the contrary, the emails, which concern counterparties and were sent in the aftermath of the Lehman Brothers collapse, demonstrate an effort to learn more about counterparty risk in the face of a global financial crisis and reflect the senders' good faith belief in the legitimacy of the SSC strategy. *See* FG Def. Br. at 39-40.

The cases cited by Plaintiffs are readily distinguishable. In *Fraternity Fund* and *Nathel*, defendants were alleged to have engaged in self-dealing or secret payments.[38] Plaintiffs do not allege any such conduct here. The other cases cited by Plaintiffs are similarly inapposite.[39] Nor do

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[38] *See Fraternity Fund Ltd. v. Beacon Hill Asset Mgmt. LLC*, 376 F. Supp. 2d 385, 404 (S.D.N.Y. 2005); *Nathel v. Siegal*, 592 F. Supp. 2d 452, 465 (S.D.N.Y. 2008).

[39] *See Novak v. Kasaks,* 216 F.3d 300, 311 (2d Cir. 2000) (defendants acted intentionally to artificially inflate financial results by refusing to mark down inventory they knew was worthless, obsolete, and unsalable); *Cornwell v. Credit Suisse Group*, No. 08 Civ. 3758(VM), 2010 WL 537593, at *6 (S.D.N.Y. Feb. 11, 2010) (plaintiffs alleged through array of confidential witnesses that executives reviewed specific reports that should have alerted them to the problems); *In re Marsh & Mclennan Cos., Inc. Sec. Litig.*, 501 F. Supp. 2d 452, 486 (S.D.N.Y. 2006) (NYAG investigation and discovery of widespread misconduct shortly thereafter were strong circumstantial evidence that president and CEO either knew or were reckless in not learning of the fraudulent business practices); *Makor Issues & Rights, Ltd. v. Tellabs Inc. (Tellabs II)*, 513 F.3d 702, 712 (7th Cir. 2008) (confidential sources prepared to testify that sales "were dropping off a cliff while the company pretended that demand was strong").

they allege that the FG Defendants had access to any documents revealing Madoff's fraud or contradicting information provided in the PPMs.[40]

c. <u>The FG Defendants Were Not Reckless with Respect to Disclosures in the PPMs about Madoff-Related Risks</u>

Plaintiffs do not allege that they were unaware of the fact that the SSC Funds were invested in Madoff or that Madoff held the roles of investment manager, executing broker, and custodian.[41] Indeed, the SSC Funds were perhaps the most well-known Madoff "feeder funds." This is not a case where plaintiffs were in the dark about who would manage their money.[42]

Instead, Plaintiffs allege that the risk engendered by Madoff holding multiple roles was not sufficiently disclosed. Pl. Br. at 13-14. But this assertion has no basis in either law or fact. Plaintiffs were sophisticated investors deemed as a matter of law to have had the ability to discern the risks of a concentration of functions at BMIS. *See, e.g.*, *Emergent Capital Inv. Mgmt., LLC v. Stonepath Group, Inc.*, 343 F.3d 189, 195 (2d Cir. 2003). Moreover, the cautionary language in the PPMs was more than sufficient to alert Plaintiffs to the relevant risks. *See*, *e.g.*, 08/14/06 Sentry PPM (Ex. 1) at 21 (warning of the "risk that the personnel of any entity with which the Fund invests could misappropriate the securities or funds (or both) of the Fund."); *see also*

[40] Plaintiffs' citation to the Massachusetts Securities Division's Administrative Complaint is misleading and improper. *See* FG Def. Br. at 42 n.35. Indeed, the Division reviewed many, if not all, of the same material cited by Plaintiffs and concluded that fraud charges were not warranted.

[41] Nor could Plaintiffs plead such ignorance. BMIS's managerial role was disclosed in the class period. *See, e.g.*, 07/01/00 Sentry PPM at 17 (attached to the 5/21/10 Declaration of Peter E. Kazanoff ("Kazanoff Decl.") as Ex. 2; *see also* 01/01/98 Sentry PPM (Kazanoff Decl. Ex. 1) at 15; 01/01/02 Sentry PPM (Kazanoff Decl. Ex. 3) at 12; 08/14/06 Sentry PPM (Ex. 1) at 9-10. Plaintiffs' contention that Madoff should have been called the "investment manager" is illogical because, as Plaintiffs themselves allege in the SCAC, that role was held by Fairfield entities. *See, e.g.*, SCAC ¶¶ 118-119. BMIS's role as sub-custodian and executing broker was also disclosed. *See* FG Def. Br. at 35; 08/06 GS COM (Ex. 3) at 2 and 08/14/06 Sentry PPM (Ex. 1) at 16.

[42] By contrast, plaintiffs in *CRT v. Merkin*, Index No. 601042/09 (N.Y. Sup Ct. May 5, 2010) alleged that the financier Ezra Merkin concealed that his Ascot Fund was a feeder fund to Madoff, and gave plaintiffs the false impression that he would himself be controlling and actively managing the fund. Moreover, also contrary to the claims here, plaintiffs in *Merkin* alleged that investors were misled by descriptions in the Ascot Fund's offering memorandum of non-SSC strategies that were never implemented.

07/01/00 Sentry PPM (Kazanoff Decl. Ex. 2) at 17 (cautioning that "the Company is subject to the judgment, decisions and trading opinions of [BMIS] and has no control over the decisions implemented by [BMIS]."). Plaintiffs' cherry-picking of certain PPMs that contain fewer disclosures during the eighteen-year class period is unavailing. "Mere allegations that statements in one report should have been made in earlier reports do not make out a claim of securities fraud." *Acito v. IMCERA Group, Inc.*, 47 F.3d 47, 53 (2d Cir. 1995).[43]

d. The Alleged Red Flags Were Not Obvious Signs of Fraud

Plaintiffs admit that, despite their use of the term "red flags" in the SCAC, these were mere "indications of problems with the Funds" that, in their opinion, should have prompted further investigation. Pl. Br. at 21. This is insufficient to show that the FG Defendants acted with a "state of mind approximating actual intent, and not merely a heightened form of negligence." *Novak*, 216 F.3d at 312 (internal quotation marks and citations omitted).

In their opening brief, the FG Defendants cited cases dismissing securities fraud claims similarly premised on the theory that the defendants should have been more skeptical or performed more thorough due diligence. *See* FG Def. Br. at 33-34. Plaintiffs' attempt to distinguish these cases on the basis that the SCAC contains more detailed allegations is unavailing. *Cf. In re PXRE Group, Ltd. Sec. Litig.*, 600 F. Supp. 2d 510, 539 (S.D.N.Y. 2009), *aff'd*, *Condra v. PXRE Group Ltd.*, 357 F. App'x 393 (2d Cir. 2009).[44] The court in *PXRE* set forth an exacting standard:

> Absent allegations that the individual Defendants disregarded an employee's specific and direct communication about the alleged flaws in PXRE's loss estimation process, the Court

[43] The most plausible (and accurate) inference here is that the PPMs changed as Fairfield's understanding of the appropriate level of disclosures evolved over time. For example, Fairfield changed its description about BMIS's activities in 2006, after the SEC concluded that Madoff should register as an Investment Advisor. *See* 08/14/06 Sentry PPM (Ex. 1) at 9-10. Moreover, drawing an inference of scienter from changes in the PPMs would discourage companies from supplementing their disclosures.

[44] There, PXRE's chief actuary expressed a number of concerns about the company's loss estimation figures, but because he did not identify the specific problem (flaws in the estimation process) the court held that recklessness on the part of the company and its senior managers could not be inferred. *Id.* at 540.

> does not find one employee's expression of 'concern' about the initial loss estimation figures, especially in the wake of the unprecedented and uncertain monetary losses incurred by Hurricanes Katrina, Rita, and Wilma, necessarily constitutes evidence of negligence, let alone recklessness.

Id. at 540. Plaintiffs here do not allege that any FG Defendant received specific and concrete information that Madoff was perpetrating a fraud, or that the information provided to Plaintiffs in the PPMs was inaccurate.

None of the purported red flags cited in the Opposition was an obvious sign that Madoff was a fraud, as demonstrated below.

Transparency – First, the SCAC demonstrates that Fairfield, and the SSC Funds' independent auditor PwC, did have access to Madoff. *See* SCAC ¶¶ 213; 218; 223; 271-272. Second, the allegation that Madoff's secrecy was a red flag was rejected as a basis for pleading scienter by Judge Stanton in *SEC v. Cohmad Sec. Corp.*, No. 09 Civ. 5680(LLS), 2010 WL 363844, at *4 (S.D.N.Y. Feb. 2, 2010).

Relationship between BMIS and the SSC Funds – The fact that BMIS had multiple roles with respect to the SSC Funds was not an obvious sign of fraud. Indeed, there are dozens of money managers who maintain custody over investors' assets. And Plaintiffs' opinion that the arrangement, despite the fact that it was consensual, should have alerted the FG Defendants to the need for higher scrutiny is not a sufficient basis on which to plead conscious recklessness. *Cf. Shields v. Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1129 (2d Cir. 1994); *see also In re Citigroup, Inc. Sec. Litig.*, 330 F. Supp. 2d at 377. Moreover, as discussed above, BMIS's different roles with respect to the SSC Funds were known and disclosed to Plaintiffs. *See supra* at 19; *cf. Meridian Horizon Fund, LP v. Tremont Group Holdings, Inc.*, No. 09 Civ. 3708, 2010 WL 1257567, at *6 (S.D.N.Y. Mar. 31, 2010) ("[P]laintiffs' reference to the concentration of functions at BMIS as a 'red flag' indicator of fraud is equally unavailing").

Returns – Madoff's success was not evidence of his fraud. *See Cohmad Sec. Corp.*, 2010 WL 363844, at *5 ("In light of Madoff's established reputation as a successful and respected investment adviser, the high returns he produced were not generally perceived (even by professionals) as a badge of fraud."); *Stephenson*, 2010 WL 1244007, at *20 ("[E]ven in the present economic climate the Court is unwilling to hold that success in securities trading is a red flag."). Moreover, Plaintiffs concede, as they must, that they were aware of the rates of return and still chose to invest. Pl. Br. at 28.

Trades – That Fairfield received paper trade confirmations a few days after the trades were executed, rather than electronically on the day of the trade, makes sense given that it sometimes took Madoff three or more days to enter or exit a position. Thus, same-day transparency could have alerted competitors to his anticipated moves in the market, and they could have traded in front of him. Moreover, the short delay in providing trade confirmations should be placed in the context of an industry in which it was rare for hedge fund managers to provide investment managers with daily confirmations at all. Indeed, the sending of the confirmations suggests legitimacy, not fraud. Further, Plaintiffs do not allege that Fairfield attempted to hide the fact that it received BMIS trade tickets on a lag. In fact, Vijayvergiya volunteered the fact in his interview with the SEC in December 2005. The lag did not raise a red flag for the SEC, just as it had not for Fairfield.

Plaintiffs' bald allegation that Madoff reported unspecified trades at prices outside the stocks' actual trading ranges or that took place on the weekends is wholly conclusory and far too vague to demonstrate fraud. SCAC ¶ 215. Moreover, Plaintiffs do not allege that any of the FG Defendants were aware of such trades. And even if they had been, the more compelling inference is that they would have viewed the reported prices and dates as typos among the thousands that corresponded with reported trading ranges and dates. *Cf. Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital Inc.*, 531 F.3d 190, 197 (2d. Cir. 2008) (competing inference of

"careless mistakes" more compelling than inference of conscious recklessness). Indeed, it would not have made sense for the FG Defendants to have continued investing their personal assets in BMIS if they believed that Madoff was fabricating trades.

SEC Investigation – Plaintiffs continue to perpetuate the myth that the SEC's 2005-2007 investigation was somehow hindered by the fact that Vijayvergiya and McKeefry communicated on one occasion with Madoff during the probe. Looking at the SEC report itself, the SEC was "fully aware" that Fairfield had spoken with Madoff about the investigation and has not alleged that the FG Defendants were anything but helpful to the SEC.[45] Fairfield fully cooperated in the investigation by, *inter alia*, (1) providing the SEC with detailed account records, PPMs and other materials;[46] (2) Tucker voluntarily providing on-the-record testimony; and (3) Vijayvergiya agreeing to a telephone interview with the SEC. Plaintiffs have not alleged that there were any misrepresentations in the PPMs regarding the investigation.

Other Alleged Red Flags – None of the other purported red flags constituted obvious signs of fraud. The size of Madoff's auditor was publicly available information, yet no one equated this with fraud, including Plaintiffs who are deemed to have been on notice of the fact. *See* FG Def. Br. at 45. Moreover, Fairfield took its "audit comfort" from the fact that its SSC Funds were audited by PwC, and BMIS was subject to NASD on-site inspections and audits.[47] The argument that the fraud should have been deduced from the fact that Madoff family members held positions at BMIS is meritless. And any Fairfield claim that it would have detected the Bayou Fund fraud is plainly not actionable. *Cf. In re Sec. Capital Assurance Ltd. Sec. Litig.*, No. 07 Civ. 11086(DAB),

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[45] *See* OIG Report (Ex. 14) at 279-280 n.195. Fairfield's General Counsel, Mark McKeefry, informed the SEC of Fairfield's discussion with Madoff both before that discussion and after it (indeed, Fairfield asked the SEC whether it could inform Madoff about the investigation and received their consent).

[46] *See* OIG Report (Ex. 14) at 269-271, 279.

[47] *Cf. In re Bausch & Lomb, Inc. Sec. Litig.*, 592 F. Supp. 2d 323, 341 n.7 (W.D.N.Y. 2008) ("It is noteworthy that B & L's outside auditors did not question B & L's accounting practices.").

2010 WL 1372688, at *25 (S.D.N.Y. Mar. 31, 2010); *In re JP Morgan Chase Sec. Litig.*, No. 02 Civ. 1282(SHS), 2007 WL 950132, at *12 (S.D.N.Y. Mar. 29, 2007).[48]

3. The Most Compelling Inference Is that the FG Defendants Were Deceived by Madoff's Elaborate Fraud

Madoff perpetrated the most well disguised Ponzi scheme in history.[49] The most plausible explanation for any alleged misstatements in the offering documents is that the FG Defendants, like countless others, fell prey to Madoff's fraud.[50] The fact that five of the six individual FG Defendants invested their personal assets with BMIS further compels the conclusion that they had no intent to defraud Plaintiffs as to Madoff's legitimacy.

4. Plaintiffs Still Fail to Address Scienter on a Defendant-by-Defendant Basis

The scarcity of references to the individual FG Defendants in the Opposition's scienter section underscores the SCAC's failure to plead scienter as to them. *See* FG Def. Br. at 36-44.

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[48] The red flag cases cited by Plaintiffs are distinguishable on their facts. *Bruhl v. PricewaterhouseCoopers Int'l*, No. 03 Civ. 23044, 2007 WL 983263, at *4 (S.D. Fla. Mar. 27, 2007) (defendants "authored memoranda and e-mails discussing that the NAVs were highly suspect and were probably being manipulated"); *In re Comverse Tech., Inc. Sec. Litig.*, 543 F. Supp. 2d 134, 143 (E.D.N.Y. 2008) (defendants signed consent forms with "as of [date]" lines that reflected purported grant dates 6-57 days in the past); *In re Refco*, 503 F. Supp. 2d 611, 652 (S.D.N.Y. 2007) (red flag included the regular appearance and disappearance of a large receivable at the end of Refco's financial period); *Anderson v. Transglobe Energy Corp.*, 35 F. Supp. 2d 1363, 1367 (M.D. Fla. 1999); *LaSalle Nat'l Bank v. Duff & Phelps Credit Rating Co.*, 951 F. Supp. 1071, 1073 (S.D.N.Y. 1996) (PSLRA not applied and plaintiffs alleged rating agency participated in Ponzi scheme by assigning inflated rating of 'AA' (or 'AA+') to the bonds).

[49] *Cf. Cohmad Sec. Corp.*, 2010 WL 363844, at *2 ("Madoff's fraud was the use of elaborate machinery, including falsifying account statements and trade confirmations, to promote the illusion that he was making securities transactions with investors' money…."); *SEC v. Bonventre*, 10 Civ. 1576, 2010 WL 666226 (S.D.N.Y. filed Feb. 24, 2010), Compl. ¶ 74 ("BMIS was subjected to several rounds of scrutiny by investor representatives and regulators" and "Madoff […] responded not only with oral and written misrepresentations, but also with an impressive array of reports and data to corroborate BMIS' fictitious trading"); *see also SEC v. O'Hara and Perez*, 09 Civ. 9425, 2009 WL 3794411 (S.D.N.Y. filed Nov. 13, 2009), Compl. ¶ 2.

[50] *Cf. Meridian Horizon Fund*, 2010 WL 1257567, at *6 ("the more compelling inference as to why Madoff's fraud went undetected for two decades was his proficiency in covering up his scheme and deceiving the SEC and other financial professionals"); *Cohmad*, 2010 WL 363844, at *2 ("[T]he complaint supports the reasonable inference that Madoff fooled the defendants as he did individual investors, financial institutions, and regulators."); *see also In re Bayou Hedge Fund Litig.*, 534 F. Supp. 2d at 418.

- The only references to Noel relate to his purported title, general responsibilities, earnings, and alleged receipt of the three emails addressed *supra* at 17-18.

- The only additional reference to Piedrahita is the general allegation that he, along with Tucker, Vijayvergiya, and Lipton "had control over Funds' assets, including those invested in Madoff."

- The only additional reference to Vijayvergiya concerns the conversation that he and McKeefry had with Madoff during the 2005-2007 SEC investigation, addressed *supra* at 23; FG Def. Br. at 42-43.

- The only other reference to Tucker, Lipton, and McKeefry is that they were privy to an email that discussed the size of BMIS's auditor, which was not a red flag for the reasons addressed *supra* at 23; FG Def. Br. at 40.

The core operations doctrine cited by Plaintiffs does not absolve them of their obligation to allege "how and why each defendant actually knew, or was reckless in not knowing" about the alleged misstatements. *In re PXRE Group, Ltd. Sec. Litig.*, 600 F. Supp. 2d at 536. Moreover, courts in this District have expressed skepticism as to whether the doctrine has survived the passage of the PSLRA. *See In re NovaGold Resources Inc. Sec. Litig.*, 629 F. Supp. 2d 272, 304 (S.D.N.Y. 2009); *In re eSpeed, Inc. Sec. Litig.*, 457 F. Supp. 2d 266, 294 n.209 (S.D.N.Y. 2006). Plaintiffs certainly cannot use the doctrine to "exhume[] the pre-PSLRA concept of status-based liability without regard to an individual defendant's scienter." Gregory A. Markel & Martin L. Seidel, *'Core Operations' Doctrine May Undermine PSLRA*, N.Y. L. J., Apr. 29, 2010; *cf. Plumbers & Steamfitters Local 773 Pension Fund v. Canadian Imperial Bank of Commerce*, No. 08 Civ. 8143(WHP), 2010 WL 961596, at *9 (S.D.N.Y. Mar. 17, 2010).[51] Even if some of the doctrine remains, Plaintiffs have not cited to any cases in which the doctrine was used to impute knowledge to defendants about a fraud that occurred outside their own company. Moreover, in the cases cited by Plaintiffs, the defendants had access to information that contradicted their public

[51] *See also In Teamsters Allied Benefit Funds v. McGraw*, No. 09 Civ. 140(PGG), 2010 WL 882883, at *10 (S.D.N.Y. Mar. 11, 2010); *Kinsey v. Cendant Corp.*, No. 04 Civ. 0582, 2005 WL 1907678, at *5 (S.D.N.Y. Aug. 10, 2005); *Glickman v. Alexander & Alexander Servs., Inc.*, No. 93 Civ. 7594, 1996 WL 88570, at *14 (S.D.N.Y. Feb. 29, 1996).

statements or are otherwise inapposite.[52] *Cf. In re Aegon N.V. Sec. Litig.*, No. 03 Civ. 0603, 2004 WL 1415973, at *18 (S.D.N.Y. June 23, 2004).[53]

B. Plaintiffs Do Not Allege Justifiable Reliance

Plaintiffs fail to allege justifiable reliance because the PPMs pursuant to which they invested contained meaningful and unambiguous cautionary language, including a warning that there was a "risk that the personnel of any entity with which the Fund invests could misappropriate the securities or funds (or both) of the Fund." *See* 7/1/03 Sentry PPM at 23; 10/1/04 Sentry PPM at 19; 8/14/06 Sentry PPM at 21; 12/1/08 Sigma PPM at 23 (Thorne Decl. Exs. 12, 13, 1, & 2 respectively). A Section 10(b) claim "must be dismissed as a matter of law where the cautionary language provided explicitly warns of or directly relates to the risk that brought about a plaintiff's loss." *San Diego County Employees Ret. Ass'n v. Maounis*, No. 07 Civ. 2618(DAB), 2010 WL 1010012, at *15 (S.D.N.Y. Mar. 15, 2010) (internal quotation marks and citation omitted). Plaintiffs' suggestion that the cautionary language in the PPMs was ineffective because the FG Defendants had an information advantage is without merit. Like thousands of others, the FG Defendants had no inkling that Madoff was a fraud.

Moreover, Plaintiffs do not contest the fact that they are deemed as a matter of law to have been on notice of all publicly available information concerning their investments. *See* FG Def. Br.

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[52] *See Cosmas v. Hassett*, 886 F.2d 8, 13 (2d Cir. 1989); *Cohen v. Koenig*, 25 F.3d 1168, 1174 (2d Cir. 1994) (defendants had personal motive to misstate financials); *Aldridge v. A.T. Cross Corp.*, 284 F.3d 72, 83-84 (1st Cir. 2002) (scienter alleged through motive allegations); *In re Veeco, Instruments, Inc. Sec. Litig.*, 235 F.R.D. 220, 231 (S.D.N.Y. 2006); *In re Atlas Air Worldwide Holdings, Inc. Sec. Litig.*, 324 F. Supp. 2d 474, 491 (S.D.N.Y. 2004) (statements made by company in trade publication revealed misconduct); *Zuckerman v. Smart Choice Auto. Group, Inc.*, No. 6:99-Civ.-237-ORL-28A, 2000 WL 33996254, at *5 (M.D. Fla. Aug. 29, 2000) (CEO had "personal notice of problems in the company's…accounting system" and CFO was "privy to information that showed the falsity of the company's financial statements"); *Chalverus v. Pegasys., Inc.*, 59 F. Supp. 2d 226, 236 (D. Mass. 1999) (defendants were likely aware of critical facts regarding transaction and had specific motive to overstate revenue); *Epstein v. Itron, Inc.*, 993 F. Supp. 1314, 1325-26 (E.D. Wash. 1998) (imputing knowledge that company's core product was "technologically incapable of meeting requirements").

[53] Since Plaintiffs do not adequately allege that anyone at Fairfield engaged in fraud, their Section 10(b) claim against the Fairfield entity defendants must also be dismissed. *See Dynex*, 531 F.3d at 195; *see also First Equity Corp. of Fla. v. Standard & Poor's Corp.*, 690 F. Supp. 256, 260 (S.D.N.Y. 1998).

at 47-48. "[T]he Second Circuit has repeatedly recognized that access to the truth bars a claim of reliance upon purported misrepresentations." *Offenbecher*, 728 F. Supp. at 145. Thus, many of the allegations on which Plaintiffs' claim rests cannot be the basis for a fraud claim, including those relating to the size of Madoff's auditors, the returns of the SSC Funds, and BMIS's roles with respect to the SSC Funds – all facts that were either known to Plaintiffs or publicly available.[54]

Plaintiffs also do not dispute that the heavy reliance on marketing materials and other documents external to the PPMs is improper. *See* FG Def. Br. at 45-47. This is an independent basis on which to dismiss the securities fraud claim.[55] *Cf. Strassman v. Fresh Choice, Inc.*, No. C-95-20017(RPA), 1995 WL 743728, at *4 (N.D. Cal. Dec. 7, 1995); *see also Shuster v. Symmetricom, Inc.*, No. C 94-20024(RMW), 1997 WL 820967, at *1 (N.D. Cal. June 25, 1997) (dismissing complaint that was "impossible to effectively review").[56]

C. Plaintiffs Fail to Plead Loss Causation

Plaintiffs' concession that the FG Defendants are "not being sued for their purported ignorance in not knowing Madoff himself was the world's biggest fraudster" is also fatal to their loss causation argument. If Plaintiffs are not suing the FG Defendants for failing to detect Madoff's scam, then there is nothing directly linking them to Plaintiffs' lost investment. *See* FG Def. Br. at 48-49.

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[54] The cases cited by Plaintiffs are inapposite. *See In re Marsh & Mclennan Cos. Inc. Sec. Litig.*, 501 F. Supp. 2d at 490 (reliance pled based on "fraud on the market theory," which is not available here); *Steed Fin. LDC v. Nomura Sec. Int'l Inc.*, No. 00 Civ. 8059, 2001 WL 1111508, at *9 (S.D.N.Y. Sept. 20, 2001) (Court could not tell from "face of the pleading what information the plaintiff had access to at the time of its purchase."); *Transit Rail, LLC v. Marsala*, No. 05-CV-0564, 2007 WL 2089273, at *10-11 (W.D.N.Y. July 20, 2007) (general disclaimer did not preclude reliance).

[55] The SCAC is saturated with references to marketing materials or other documents external to the "SSC" PPMs or materials regarding non-SSC Funds. *See* SCAC ¶¶ 179, 181, 187, 190, 191, 196-204, 227, 233.

[56] At a minimum, the Section 10(b) claim must be dismissed insofar as it relates to representations that were made in documents external to the offering memoranda. *Cf. San Diego County Employees Retirement Ass'n v. Maounis*, No. 07 Civ. 2618(DAB), 2010 WL 1010012, at *13-15 (S.D.N.Y. Mar. 15, 2010).

Moreover, even if Plaintiffs are attempting to so allege, they still have not adequately pled loss causation because they have not identified any compelling facts known to the FG Defendants and not Plaintiffs that should have alerted them to Madoff's fraud. *See supra* at 20-23. Plaintiffs' claim that their loss was caused by Fairfield's failure to "follow up on suspicious information," Pl. Br. at 38, is simply too attenuated. *Cf. Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 343 (2005).

VII. PLAINTIFFS FAIL TO PLEAD THE ELEMENTS OF THEIR TORT CLAIMS

A. Plaintiffs Do Not and Cannot Allege Proximate Causation

The immediate effective cause of Plaintiffs' injury was Madoff's criminal acts, which were a "superseding and intervening event[] breaking [any alleged] chain of causation" between any alleged misconduct by the FG Defendants and Plaintiffs' losses. *See Port Auth. of N.Y. & N.J. v. Arcadian Corp.*, 189 F.3d 305, 319 (3d Cir. 1999) (analyzing under New York law); *see also Martin v. W.B. Rest. Inc.*, 703 N.Y.S.2d 212, 213 (App. Div. 2000).

B. Plaintiffs' Common Law Fraud Claim Fails

Plaintiffs do not dispute that the elements of common law fraud under New York law are essentially the same as those required to state a claim under Section 10(b) and Rule 10b-5. *See* FG Def. Br. at 51-52. Therefore, the deficiencies requiring dismissal of the Rule 10b-5 claim also require dismissal of the common law fraud claim. The claim also fails to the extent it is based on prospective statements. *See* FG Def. Br. at 52-53.

C. Plaintiffs Fail to State a Claim for Negligent Misrepresentation

1. <u>Plaintiffs Do Not Allege A Special Relationship</u>

Plaintiffs' assertion that Defendants' "special expertise with respect to investments generally and the Madoff Funds specifically" places them in a special relationship with Plaintiffs is wholly insufficient. Pl. Br. at 55; *see Gusmao v. GMT Group, Inc.*, No. 06 Civ. 5113(GEL), 2008 WL 2980039, at *15 (S.D.N.Y. Aug. 1, 2008); *cf. Kottler v. Deutsche Bank AG*, 607 F. Supp. 2d

447, 466 (S.D.N.Y. 2009) ("Mere expertise in a subject is not enough to create a fiduciary duty"); *Gaidon v. Guardian Life Ins. Co. of Am.*, 679 N.Y.S.2d 611, 612 (N.Y. App. Div. 1998).

The SCAC does not allege that there were any bonds or communications between particular FG Defendants and particular Plaintiffs that could have given rise to the requisite special relationship. This requires dismissal of their claim.[57]

2. The Purchaser Claims Are Flawed

The "Purchaser Claims" are particularly flawed because Plaintiffs do not allege that they had any relationship whatsoever with the FG Defendants prior to their investments, let alone a special relationship. *See* FG Def. Br. at 55. Plaintiffs' argument that a pre-existing relationship is unnecessary because the Defendants' representations allegedly "induced" Plaintiffs to invest in the Funds is unavailing. *See Bangkok Crafts Corp. v. Capitolo di San Pietro in Vaticano*, No. 03 Civ. 0015(RWS), 2006 WL 1997628, at *11 (S.D.N.Y. July 18, 2006) ("[T]he Second Circuit has held that when sophisticated business parties engaged in major transactions fail to exercise care in their affairs, 'New York courts are particularly disinclined to entertain claims of justifiable reliance.'") (citations omitted).[58]

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[57] *See Kottler v. Deutsche Bank AG*, 607 F. Supp. 2d 447, 466 (S.D.N.Y. 2009); *In re Sterling Foster & Co., Inc. Sec. Litig.*, 222 F. Supp. 2d 216, 284 (E.D.N.Y. 2002); *DeBlasio v. Merrill Lynch & Co.*, No. 07 Civ. 318(RJS), 2009 WL 2242605, at *32-34 (S.D.N.Y. July 27, 2009). The contrast in the facts in the cases cited by Plaintiffs underscores their failure to plead a special relationship. In *Kimmell v. Schaefer*, 652 N.Y.S.2d 715 (1996), the defendant personally met with each plaintiff, told investors he would provide "hot comfort" should they have any reservations, and admitted that he expected plaintiffs to rely on his statements. *Id.* at 719-20. In *Muller-Paisner v. TIAA*, 289 F. App'x 461 (2d Cir. 2008), the defendants targeted their products to a specific class of persons, retirees, and represented that trust was a "crucial dimension" of the relationship. *Id.* at 466. And in *People v. Merkin*, 2010 WL 936208, the court held that a duty of care existed because the offering documents did not notify investors how their money would be invested or by whom. *Id.* at *10-11. Here, Fairfield explicitly told Plaintiffs that they could not rely on any marketing material and warned in the offering memoranda that there was a risk their assets could be misappropriated. *See, e.g.*, FG Def. Br. at 46; 7/01/03 Sentry PPM (Ex. 12) at 23.

Plaintiffs also fail to establish a privity-like relationship necessary to plead negligent misrepresentation. *Sheldon v. Khanal*, No. 08-cv-3676(KAM)(LB), 2009 WL 3233093 (E.D.N.Y. Sept. 30, 2009) is inapposite. There, the court recognized the existence of a special relationship between defendant real estate broker and plaintiff property seller for a twelve-day period during which both parties were bound by a listing agreement. *Id.* at *13-14.

Moreover, the law in this Circuit is unambiguous that "[p]romises of future conduct are not actionable as negligent misrepresentations." *Murray v. Xerox Corp.*, 811 F.2d 118, 123 (2d Cir. 1987); *accord U.S. W. Fin. Servs., Inc. v. Tollman,* 786 F. Supp. 333, 344 (S.D.N.Y. 1992); FG Def. Br. at 57. Plaintiffs' argument that their claims do not rely on promises of future conduct is belied by the allegations in the SCAC. *See* FG Def. Br. at 57.

3. Plaintiffs Do Not Allege that Each FG Defendant Was Negligent

Negligence cannot be pled collectively. *See, e.g.*, *Simon v. Castello*, 172 F.R.D. 103, 106-07 (S.D.N.Y. 1997); *Landy v. Mitchell Petroleum Tech. Corp.,* 734 F. Supp. 608, 621 (S.D.N.Y. 1990); FG Def. Br. at 57-58. None of the allegations against the individual FG Defendants demonstrates negligence. *See* FG Def. Br. at 36-44, 57-58. And Plaintiffs' generalized allegation that Defendants had control over the offering memoranda is insufficient, as a matter of law, to state a claim for negligence. *Simon*, 172 F.R.D. at 107.

4. The Exculpatory Clauses Shield the FG Defendants from Liability for Simple Negligence

Plaintiffs' negligence claims also are barred by the exculpatory clause in the Sentry and Sigma IMAs and similar provisions in the GS and GSP LPAs. *See supra* at 12; FG Def. Br. at 24-25, 58. The plain language of these clauses bars claims lying in simple negligence. *Cf. Champion Home Builders Co. v. ADT Sec. Servs., Inc.*, 179 F. Supp. 2d 16, 23-25 (N.D.N.Y. 2001) (barring negligent misrepresentation claim due to a valid exculpatory clause).

5. The Economic Loss Doctrine Bars the Negligent Misrepresentation Claim

To recover under tort when the allegations stem from contractual obligations, a plaintiff must show (1) an independent duty separate from the contract and (2) damages that are not simply

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[58] In *Century Pac., Inc. v. Hilton Hotels Corp.*, 528 F. Supp. 2d 206 (S.D.N.Y. 2007), the court found that a special relationship did *not* exist because, as here, the plaintiff was a sophisticated party to the transaction and therefore could not have reasonably relied on the defendant's representations. *Id.* at 231-32.

economic loss. *Robehr Films, Inc. v. Am. Airlines, Inc.*, No. 85 Civ. 1072(RPP), 1989 WL 111079, at *2 (S.D.N.Y. Sept. 19, 1989); *see also County of Suffolk v. Long Island Lighting Co.*, 728 F.2d 52, 62 (2d Cir. 1984). Plaintiffs do not even attempt to plead facts that address the second element, and therefore their negligent misrepresentation claim must be dismissed on this basis alone. *Cf. Manhattan Motorcars, Inc. v. Automobili Lamborghini, S.P.A.*, 244 F.R.D. 204, 220 (S.D.N.Y. 2007). Moreover, Plaintiffs fail to allege an independent duty separate from contract for the same reasons they fail to plead a special relationship.

D. Plaintiffs Fail to State a Claim for Breach of Fiduciary Duty

Plaintiffs' breach of fiduciary duty claim is fundamentally related to the internal affairs of the Funds (*see* SCAC ¶¶ 402-409) and therefore governed by the law of the state of the Funds' incorporation – BVI and Delaware. *See supra* at 3. Plaintiffs do not dispute that their breach of fiduciary duty claim fails under BVI law. Therefore, the claim brought by Plaintiffs who invested in the Offshore BVI Funds must be dismissed.

The claim brought by Plaintiffs who invested in the Onshore Funds also must be dismissed because the exculpation provisions of the LPAs bars the claim under both Delaware law and New York law. *See Banc of Am. Sec. LLC v. Solow Bldg. Co. II, LLC*, 47 A.D.3d 239, 244 (N.Y. App. Div. 2007); *Official Comm. of Unsecured Creditors v. Donaldson, Lufkin & Jenrette Sec. Corp.*, No. 00 Civ. 8688(WHP), 2002 WL 362794, at *15-16 (S.D.N.Y. Mar. 6, 2002); FG Def. Br. at 60-63.[59]

[59] Plaintiffs are mistaken that a claim of breach of fiduciary duty cannot be resolved as a matter of law. Pl. Br. at 53; *see Indep. Order of Foresters v. Donald, Lufkin & Jenrette, Inc.*, 157 F.3d 933, 940 (2d Cir. 1998); *Henneberry v. Sumitomo Corp. of Am.*, 532 F. Supp. 2d 523, 554 (S.D.N.Y. 2007). Indeed, in both cases cited by Plaintiffs, the court dismissed fiduciary duty claims for failure to allege a fiduciary relationship. *See Musalli Factory for Gold & Jewellry v. JPMorgan Chase Bank, N.A.*, 261 F.R.D. 13, 26 (S.D.N.Y. 2009); *Abercrombie v. Andrew Coll.*, 438 F. Supp. 2d 243, 274 (S.D.N.Y. 2006).

Plaintiffs also fail to allege the deceit needed to state a claim for breach of fiduciary of duty. *See Flickinger v. Harold C. Brown & Co., Inc.*, 947 F.2d 595, 599 (2d Cir. 1991).[60]

E. Plaintiffs Fail to State a Claim for Gross Negligence

In *Baker v. Andover Assocs. Mgmt. Corp.,* Index No. 6179/09 (N.Y. Sup. Ct. Nov. 30, 2009), the court dismissed nearly-identical gross negligence claims based on similar allegations of missed red flags and the failure to perform appropriate due diligence on Madoff. Plaintiffs' argument that *Baker* is not dispositive because the FG Defendants' conduct "smacks of intentional wrongdoing" is meritless for the reasons discussed above and in the Opening Brief. *See supra* at 14-26; *see* FG Def. Br. at 66-67. The gross negligence claim is also barred by the economic loss doctrine. *Suffolk*, 728 F.2d at 62; *accord Cherny v. Emigrant Bank*, 604 F. Supp. 2d 605, 609 (S.D.N.Y. 2009) (Marrero, J.).

VIII. PLAINTIFFS ARE NOT ENTITLED TO PUNITIVE DAMAGES OR TO FURTHER AMEND THEIR COMPLAINT

Plaintiffs do not cite a single case in which punitive damages were awarded based on the "absence of due diligence and monitoring." Pl. Br. at 106. This is not surprising since such alleged conduct does not approach the type of conduct that is "so gross, wanton, and willful, or of such high moral culpability, as to warrant an award of punitive damages." *Outside Connection, Inc. v. DiGennaro*, 795 N.Y.S.2d 669, 670 (App. Div. 2005).

Permitting a further amendment would be futile. For the reasons set forth by Fairfield in this motion, the deficiencies in Plaintiffs' claims cannot be overcome by more artful pleading.

CONCLUSION

For all the foregoing reasons, the FG Defendants' motion to dismiss should be granted in all respects.

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[60] *People v. Merkin* is distinguishable on that basis. There, Justice Lowe found that the required deceit had been met because Merkin had concealed "that the funds were with Madoff." *Merkin*, 2010 WL 936208, at *12.

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