Repex Ventures S.A v. Madoff et al Doc. 323

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE HERALD, PRIMEO AND THEMA FUNDS SECURITIES LITIGATION This document relates to: All actions.	File No: 09 Civ. 0289 (RMB) (HBP)

LEAD PLAINTIFFS' MEMORANDUM OF LAW IN OPPOSITION TO DEFENDANTS' JOINT MOTION TO DISMISS AND IN FURTHER SUPPORT OF PLAINTIFFS' MOTION FOR LEAVE TO AMEND

COHEN MILSTEIN SELLERS & TOLL PLLC
1100 New York Ave. N.W.
Suite 500, West Tower
Washington, D.C. 20005
(202) 408-4600

STULL, STULL & BRODY
10940 Wilshire Boulevard
Suite 2300
Los Angeles, California 90024
(310) 209-2468

CHAPIN FITZGERALD SULLIVAN & BOTTINI LLP
550 West C Street
Suite 2000
San Diego, California 92101
(619) 241-4810

Lead Counsel for Plaintiffs

Dockets.Justia.com

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GLOSSARY OF DEFINED TERMS*

TERM	DEFINITION
2006 KPMG Report	KPMG's February 16, 2006 report entitled "Review of fraud risk and related operational risks at Bernard L. Madoff Investment Securities LLC"
2008 KPMG Report	KPMG's report issued on September 8, 2008
Auditor Defendants	E&Y and PwC Defendants
BA Worldwide	BA Worldwide Fund Management Ltd.
Bank Medici	Bank Medici n/k/a/ 20:20 Medici AG
E&Y / E&Y Defendants	EYG, EY Cayman, and EY Lux
F&H	Friehling & Horowitz
GB&C	Genevalor, Benbassat & Cie
GSCC	Government Securities Clearing Corporation
HAML	Herald Asset Management Limited
HSBC Bank USA	HSBC Bank USA, N.A.
Liquidators	Luxembourg Liquidators for the Herald Lux Fund
PIM	Pioneer Alternative Investment Management, Ltd.
PwC / PwC Defendants	PwC Bermuda, PwCIL, PwC Ireland, PwC U.S.

* Capitalized terms not found in Defendants' Glossary have been defined below.

Lead Plaintiffs respectfully submit this memorandum of law in opposition to Defendants' joint motion to dismiss and in further support of Plaintiffs' motion for leave to amend.

STATEMENT OF FACTS

Plaintiffs' claims arise from the massive Ponzi scheme perpetrated by Bernard Madoff through his investment firm BLMIS. HC ¶ 1; PC ¶ 1; TC ¶ 5. Madoff, however, did not act alone. For more than twenty years, the Defendants in this action – including the Funds' custodians, administrators, advisors, accountants, Sonja Kohn, Bank Medici, Unicredit S.A., and Madoff's bankers – fed into the Ponzi scheme billions of dollars unsuspecting investors had entrusted to them. HC ¶ 1; PC ¶¶ 2, 6; TC ¶¶ 7-8.

Indeed, according to Madoff, in order to make a profit for themselves, each of the Defendants was willfully blind to his Ponzi scheme. "They had to know," Madoff stated: "I am saying that the banks and funds were complicit in one form or another." He added, "the attitude was sort of, 'If you're doing something wrong, we don't want to know.'" HC ¶ 4.

Madoff's own description of these circumstances explains why Defendants knowingly disregarded the scores of repeated and obvious red flags that confronted them. *See*, *e.g.*, HC ¶¶ 3, 5, 54, 430-85, 488-510, 551-67, 576, 578, 582, 585-86, 606-13, 615-16, 622-27; PC ¶¶ 4, 11, 72, 136-46, 152-54, 156-67, 168-92; TC ¶¶ 10, 12, 137-40, 144-47, 152-56, 157-86, 192-208, 215, 221-23, 227-29, 242, 246, 263, 275-76, 286, 319, 323-34, 339-50, 352, 359-60, 363, 369-85. Defendants did not innocently miss those red flags. Rather, they ignored them for their own financial benefit. *See*, *e.g.*, HC ¶¶ 2, 66, 197-207, 222, 240-41, 328-29; PC ¶¶ 3, 6, 8, 20, 73, 76, 81, 84, 88, 95, 109, 149, 154; TC ¶¶ 11, 16, 19, 50, 52, 154, 156, 302-06, 320.

Plaintiffs filed these consolidated actions in an attempt to recover a portion of the hundreds of millions of dollars illegally reaped by Defendants. Plaintiffs each invested in one or

more of the Funds during the class periods.[1] Plaintiff Repex Ventures, S.A., invested in Herald Lux (HC ¶ 8) and Dana Trezziova invested in Herald SPC (HC ¶ 9); Plaintiffs Dr. Shmuel Cabilly and Korea Exchange Bank invested in the Primeo Funds (PC ¶¶ 5, 15-16); and Plaintiff Neville Seymour Davis invested in the Thema Fund (TC ¶ 15).

Defendants Ignored Bright Red Flags Indicating Madoff's Fraud

Tellingly, for years since the inception of Madoff's Ponzi scheme, there were myriad warnings meaningful to outside investment professionals that Madoff and/or BLMIS were perpetrating a fraud on investors. *See*, *e.g.*, HC ¶¶ 590-605; TC ¶¶ 10, 371. Perhaps the most famous summary is Harry Markopolous' November 7, 2005 letter to the SEC, entitled "The World's Largest Hedge Fund is a Fraud," in which he identified 29 red flags that demonstrated Madoff's returns could not be real. HC ¶ 606; TC ¶¶ 375-76. The red flags identified by Markopolous included his observations that: Madoff earned only 1% in management fees instead of 20% in commissions; Madoff would borrow "money at an average rate of 16.00% *per annum*" while allowing third-party hedge funds to pocket commissions based on "Madoff's hard work and brains"; funds that invested with Madoff were not "allowed to name Bernie Madoff as the actual manager in their performance summaries or marketing literature"; Madoff's supposed "strategy using index call options and index put options [had] a low correlation to the market where its returns [were] supposedly being generated"; Madoff and BLMIS "never had more than

[1] The Complaints have three different class periods. The Herald Class is defined as "all persons or entities who (i) owned shares of Herald Funds on December 10, 2008, or (ii) purchased shares of Herald Funds from January 14, 2004 to December 10, 2008 (the 'Class Period'), and who were damaged thereby due to the wrongful conduct alleged in this Complaint." HC ¶ 6-7. The Primeo Class is defined as "all persons or entities who (i) owned shares of the Primeo Funds on December 10, 2008, or (ii) purchased shares of the Primeo Funds from January 12, 2004 to December 12, 2008 (the 'Class Period'), and who were damaged thereby due to the wrongful conduct alleged in this Complaint." PC ¶ 14. The Thema Class is defined as "all persons and entities who owned shares of Thema International Fund plc (collectively referred to, together with its sub-fund the Thema Fund as 'Thema' on December 10, 2008 (the 'Class Period'), and suffered damages thereby due to the wrongful conduct alleged in this Second Amended Complaint." TC ¶ 409.

a one month losing streak"; "Madoff [did] not allow outside performance audits"; "Madoff's returns [were] not consistent with the one publicly traded option income fund with a history as long as Madoff's"; and BLMIS "[went] to 100% cash for every December 31st year-end" and "[a]ny unusual transfers or activity near a quarter-end or year-end is a red flag for fraud." HC ¶¶ 607-13; TC ¶¶ 375-76.

Similarly, in 2007, hedge fund investment adviser Aksia LLC urged its clients not to invest in Madoff feeder funds after performing due diligence on Madoff and discovering several red flags, including: Madoff's comptroller was based in Bermuda, whereas most mainstream hedge funds have their own in-house comptrollers; Madoff's auditor, F&H, operated out of a 13 x 18 foot location in New City, New York, and included only one active accountant; the 2005 Markopolous letter; and BLMIS' stock holdings, as reported in quarterly statements filed with the SEC, demonstrated that Madoff's holdings were too small to support the size of the assets Madoff claimed to be managing. HC ¶¶ 614-18, 639; PC ¶ 189; TC ¶ 378.

Numerous other investment advisors also examined Madoff's trading and were unable to reconcile investors' account statements with the reported returns. HC ¶¶ 619-27; PC ¶¶ 190-92; TC ¶¶ 380-82. In stark contrast, Defendants, each with information gained from their dealings with Madoff, BLMIS and/or Kohn, ignored even more glaring red flags in order to garner their own profits.

The HSBC Defendants

The HSBC Defendants were the primary custodians and administrators of the monies invested with the Funds. HC ¶ 486; PC ¶ 149, 156; TC ¶ 102. However, in actuality, HSBC violated industry practices and ceded control to Madoff and BLMIS, who served as their *own* custodians of the Funds' billions in assets. Among the substantial red flags that the HSBC Defendants ignored were the facts that, *inter alia*, Madoff and/or BLMIS claimed trades that

approached or exceeded the entire volume of trades in a particular stock on a given trading day; purportedly executed trades outside the daily price range and/or that settled on days when the market was closed; appeared to have a near-perfect ability to buy low and sell high not only from day to day, but *within* each trading day; claimed to trade options at rates higher than existed in the option market; and allowed the Funds to maintain negative cash balances on hundreds of occasions. HC ¶¶ 498-502; PC ¶ 150; TC ¶ 172.

Beginning as early as 2001, HSBC divisions questioned Madoff's results, coming to the conclusion that his uninterrupted success was impossible. HC ¶¶ 496-97; PC ¶¶ 157-60; TC ¶¶ 175-76, 178. Indeed, even though Madoff and/or BLMIS were allegedly trading billions of dollars in stock and options, BLMIS never transmitted any information electronically. Instead, when the HSBC Defendants requested trade confirmation information, Madoff and/or BLMIS transmitted incomplete paper copies of trade confirmations to the Defendants and/or their affiliates or representatives, sometimes days after the trades purportedly occurred and with substantial errors on the forms. HC ¶ 498; TC ¶¶ 10, 289.

Moreover, Madoff and/or BLMIS did not charge any of the Defendants, including the HSBC Defendants, fees in connection with their BLMIS investments. HC ¶ 501; TC ¶ 10. Instead, as noted *supra*, Madoff and BLMIS' alleged earnings were only from commissions, with Madoff effectively abandoning hundreds of millions of dollars. HC ¶ 501; TC ¶ 12.

Most importantly, in September 2005, the HSBC Defendants engaged KPMG to assess BLMIS' business on behalf of the Funds for which the HSBC Defendants served as the primary custodian. HC ¶ 501; PC ¶ 161; TC ¶ 179. KPMG provided the HSBC Defendants with its findings in the 2006 KPMG Report. According to the 56-page 2006 KPMG Report, 25 "fraud and related operational risks were identified throughout the process whereby Madoff LLC receives, checks and accounts for client funds," including falsification of client orders;

embezzlement of client funds; use of fabricated client instructions to disguise poor proprietary positions; failure to segregate client funds from BLMIS funds; diversion of client funds for Madoff's personal gain; inaccurate allocation of reinvested funds from across individual accounts; manipulation of option prices to maximize commissions; exercise of options without informing the client that the option was set to expire; use of client funds to make opportunistic trades that deviated from the so-called "split-strike conversion strategy"; diversion of cash resulting from the sale of equities and U.S. Treasury bills; systematic over-valuing of positions and failure to report positions to HSBC; stocks not held in client names; inflation of call values to disguise misappropriation or poor positions; unauthorized trading in client accounts; trades executed by unauthorized BLMIS staff members; sham trades to divert client cash; front-running order flow in the market-making business; false reporting of trades without execution to collect commissions; and falsification of trade confirmations. HC ¶ 502; PC ¶ 162; TC ¶ 180.

Moreover, "KPMG was particularly concerned that it could not identify the owners of individual HSBC client assets, and that controls in place at BLMIS might not prevent fraud or errors in client accounts." HC ¶ 504; PC ¶ 162; TC ¶ 181. At the time KPMG issued the 2006 KPMG Report, "HSBC was custodian for eight funds that had invested $2 billion with Madoff." The HSBC Defendants did nothing in response to the 2006 KPMG Report other than retain KPMG to review Madoff and/or BLMIS' business activity again in March 2008. As a result of that review, KPMG issued the "2008 KPMG Report, which noted additional concerns including diversion of client cash and falsification of signatures on client instructions in an attempt to legitimize unauthorized transactions and misallocation of prices for individual transactions following bulk trades. HC ¶¶ 505-07; PC ¶¶ 164-66; TC ¶¶ 183-85.

Chillingly, despite KPMG's detailed review of Madoff's fraud, the HSBC Defendants forged ahead in their complicity with Madoff, at the expense of Plaintiffs and the proposed

classes.

The Auditor Defendants

The E&Y and PwC Defendants collaborated with Madoff by issuing the audit opinions provided to Fund investors. HC ¶ 511; PC ¶ 104; TC ¶ 114. Indeed, the Auditor Defendants failed to fulfill their only obligation: to confirm that the Funds' assets actually existed. The Auditor Defendants issued clean audit opinions with respect to the Funds despite knowing that they had not obtained sufficient, competent evidential matter to support their opinions that the Funds' financial statements were free of material misstatements with respect to the claimed assets. HC ¶¶ 511, 521; PC ¶ 104; TC ¶ 246. Indeed, Madoff told the Auditor Defendants that he traded U.S. Treasury bills through the GSCC and held them at BNY Mellon.[2] HC ¶ 512; TC ¶¶ 60, 122. None of the Auditor Defendants ever contacted GSCC or BNY Mellon to confirm the existence of the billions of dollars in U.S. Treasury bills reported on the Funds' balance sheets at the end of each year – the Funds' only assets. HC ¶ 512; PC ¶¶ 377, 384; TC ¶ 293. If they had, they would have discovered that the U.S. Treasury bills did not exist. The Auditor Defendants also never communicated with Madoff's auditors F&H, nor investigated F&H's credentials, despite the fact that one of the first procedures mandated by applicable auditing standards required the Auditor Defendants to vet Madoff's auditor. HC ¶ 513; TC ¶ 13.

Had the Auditor Defendants performed appropriate audits (as they represented they had), they would have learned that the securities transactions purportedly conducted by Madoff did not occur and the Funds' assets did not exist. Indeed, the Auditor Defendants breached their duties as independent auditors of the Funds by, *inter alia*, failing to exercise due professional care and professional skepticism in their audits; obtain a sufficient understanding of the Funds and their environment, including their internal controls; assess the risk of material misstatement of the

[2] BNY Mellon, is named in the Thema Complaint for its misconduct in connection with accounts maintained by BLMIS. *See* TC ¶ 60.

Funds' financial statements whether due to error or fraud; obtain sufficient competent audit evidence with respect to existence of the Funds' BLMIS' investments; obtain an understanding of the internal controls (or lack thereof) at BLMIS; perform the procedures necessary to audit the transactions which constituted the purported split-strike conversion strategy, such as confirmation with counterparties, confirmation of settled transactions, and physical inspection of securities; and perform additional procedures required in situations where, as here, there was a lack of segregation of duties at the service organization. HC ¶¶ 521-67; PC ¶¶ 111-146; TC ¶¶ 247-300.

The JPMorgan Defendants

J. P. Morgan Chase & Co.[3] and/or its subsidiaries and/or agents acted as Madoff's and/or BLMIS' primary banker. HC ¶ 430; PC ¶ 23; TC ¶¶ 59. Moreover, the JPM Defendants made substantial investments in the Funds and, as a result of internal due diligence, encountered red flags that allowed them to timely divest of their investments before and at the detriment of Plaintiffs and other members of the classes. HC ¶¶ 430-59; TC ¶ 351.

The JPM Defendants began due diligence related to JPM's investments in BLMIS in early 2007, and continued their due diligence through 2008. HC ¶¶ 431-32, 433-35, 447-51; TC ¶ 341. As a result of their inquiries, the JPM Defendants learned that there was lack of transparency among investors, Madoff, Kohn and the Funds; resistance on Madoff's part to provide meaningful disclosure of his investment activities; involvement of Madoff's family throughout BLMIS; lack of effective due diligence and monitoring by the Funds; lack of an independent and competent auditor at BLMIS; and unanswered questions regarding BLMIS' trading, as no one but Madoff understood how it was done. HC ¶ 456; TC ¶¶ 341-42, 344.

Madoff and/or BLMIS also maintained BLMIS' primary bank account with JPM, and

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[3] The JPM Defendants are not named in the Primeo Complaint.

collected "an estimated half a billion dollars in fee and interest payments" thereon. HC ¶ 460; TC ¶ 325. As a national bank, JPM was required to comply with numerous federal banking regulations, which, among other things, required the bank to monitor and "know" its customer. HC ¶¶ 460-66; TC ¶¶ 328-44. Despite these regulations, JPM ignored red flags regarding BLMIS' account, in particular that its required banking reports often failed to show BLMIS' assets and liabilities, including: (i) cash held in the BLMIS account; (ii) loans provided to BLMIS by the JPM Defendants; and (iii) related collateral on the loans JPM extended to BLMIS; and that the account suffered from severe banking irregularities, including: (i) frequent transactions with the same parties, often on the same day, with no obvious purpose; (ii) total monthly cash inflows from a customer equal to total monthly cash outflows to the same customer; (iii) a pattern of large dollar transactions; (iv) a significant increase in the total dollar amount transacted; (v) dramatic spikes in the BLMIS account's offshore activity; and (vi) handwritten checks totaling hundreds of millions of dollars in a single day, with the majority of the account's transactions actually conducted by check. HC ¶¶ 469-84; TC ¶¶ 344-45, 352, 355.

Despite these internal banking red flags, the JPM Defendants worked for their own benefit to garner more banking fees and avoid losses on JPM's own Madoff-related investments.

The facts surrounding Madoff's Ponzi scheme, which were at least recklessly ignored by Defendants, came to light following Madoff's arrest in December 2008. Plaintiffs filed their initial complaints in this action beginning in January 2009.

ARGUMENT

I. LEGAL STANDARD FOR MOTIONS TO DISMISS

Rule 8(a)(2) of the Federal Rules of Civil Procedure governs Plaintiffs' claims.[4] Accordingly, to survive a motion to dismiss pursuant to Fed. R. Civ. P. 12(b)(6), Plaintiffs must

[4] Plaintiffs' fraud claims are subject to the pleading standard set forth in Fed. R. Civ. P. 9(b). *See infra* at Section IV.B.3

allege only a "short and plain statement of the claim showing that the pleader is entitled to relief." Fed. R. Civ. P. 8(a)(2). In *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007), the Supreme Court held that Rule 8(a) does not require "detailed factual allegations." 550 U.S. at 555. Rather, to survive a motion to dismiss, a complaint must plead "enough facts to state a claim to relief that is plausible on its face." *Id.* at 570. Additionally, "[o]nce a claim has been adequately stated, it may be supported by showing any set of facts consistent with the allegations in the complaint." *ATSI Commc'ns*, *Inc. v. The Shaar Fund*, *Ltd.*, 493 F.3d 87, 98 (2d Cir. 2007) (citing *Twombly*, 550 U.S. at 563). On a motion to dismiss, the Court should accept all factual allegations as true, and draw all reasonable inferences in Plaintiffs' favor. *See Goldstein v. Pataki*, 516 F.3d 50, 56 (2d Cir. 2008).

The Supreme Court clarified the contours of the "plausibility" requirement in *Ashcroft v. Iqbal*, ____ U.S. ____, 129 S. Ct. 1937, 1950 (2009). According to *Iqbal*, "[a] claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Iqbal*, 129 S. Ct. at 1949. "The plausibility standard is not akin to a 'probability requirement,' but it asks for more than a sheer possibility that a defendant has acted unlawfully." *Id.* Notably, the Court is not required, at this stage, to *believe* Plaintiffs' allegations. *Twombly*, 550 U.S. at 556 ("Rule 12(b)(6) does not countenance … dismissals based on a judge's disbelief of a complaint's factual allegations." (citing *Neitzke v. Williams*, 490 U.S. 319, 327 (1989)). Indeed, even if a complaint "strikes a savvy judge that actual proof of [its] facts is improbable" and "that a recovery is very remote and unlikely," all *Twombly* requires is "enough facts to raise a reasonable expectation that discovery will reveal evidence" of wrongdoing. *Id.* Plaintiffs must only "nudge[] their claims across the line from conceivable to plausible." *Id.* at 570.

II. PLAINTIFFS' CHOICE OF FORUM SHOULD BE RESPECTED

The doctrine of *forum non conveniens* permits a district court – in "rare instances," *see Wiwa v. Royal Dutch Petro. Co.*, 226 F.3d 88, 100 (2d Cir. 2000) – to dismiss a case "'when an alternative forum has jurisdiction to hear the case, and ... trial in the chosen forum would establish ... oppressiveness and vexation to a defendant ... out of all proportion to plaintiff's convenience, or ... the chosen forum is inappropriate because of considerations affecting the court's own administrative and legal problems.'" *Sinochem Int'l Co. v. Malay. Int'l Shipping Corp.*, 549 U.S. 422, 423 (2007) (citation omitted). In the Second Circuit, courts employ a three-step inquiry to determine whether a forum is inconvenient. "First, the court determines the degree of deference to be accorded to the [plaintiff's] choice of forum; second, the court considers whether there is an appropriate alternative forum to adjudicate the dispute; and third, the court balances the private and public interests implicated in the choice of forum." *Thai-Lao Lignite (Thail.) Co. v. Gov't of the Lao People's Democratic Republic*, No. 10 Civ. 5256 (KMW), 2011 U.S. Dist. LEXIS 87844, at *24 (S.D.N.Y. Aug. 3, 2011) (citing *Norex Petro. Ltd. v. Access Indus., Inc.*, 416 F.3d 146, 153 (2d Cir. 2005)). Application of these principles here makes clear that Defendants' *forum non conveniens* defense has no basis.

A. Plaintiffs' Choice of Forum Is Entitled To Deference

It is well settled that "a plaintiff's choice of forum is presumptively entitled to substantial deference." *Gross v. British Broad. Corp.*, 386 F.3d 224, 230 (2d Cir. 2004). In *Iragorri v. United Techs. Corp.*, 274 F.3d 65 (2d Cir. 2001) (*en banc*), the Second Circuit created a "sliding scale" to determine the degree of deference a plaintiff should receive: "the greater the plaintiff's or the lawsuit's *bona fide* connection to the United States and to the forum of choice and the more it appears that considerations of convenience favor the conduct of the lawsuit in the United States," the more deference will be accorded a plaintiff's choice of forum, and "the more

difficult it will be for the defendant to gain dismissal for *forum non conveniens*." *Id.* at 72. If a plaintiff's choice of forum is motivated by improper forum-shopping, on the other hand, less deference is accorded. *Id.*; *see also Terra Sec. ASA Konkursbo v. Citigroup, Inc.*, 688 F. Supp. 2d 303, 315 (S.D.N.Y. 2010) ("The sliding scale analysis distinguishes between a plaintiff's legitimate right to select a forum and mere forum-shopping that is designed to burden the defendants.").[5] As the Second Circuit cautioned in *Iragorri*, however, just as a plaintiff may engage in forum-shopping,

> defendants also may move for dismissal under the doctrine of *forum non conveniens* not because of genuine concern with convenience but because of similar forum-shopping reasons. District courts should therefore arm themselves with an appropriate degree of skepticism in assessing whether the defendant has demonstrated genuine inconvenience and a clear preferability of the foreign forum.

Iragorri, 274 F.3d at 75.

Defendants offer nothing to rebut the presumption that Plaintiffs' choice of forum is entitled to deference. Defendants do not accuse Plaintiffs of forum-shopping, nor could they. Quite the contrary: this case, like every other case in this District arising from Madoff's Ponzi scheme,[6] has a profound and "*bona fide* connection" to this forum. Indeed, a majority of the events alleged in the Complaints unfolded in this District: Defendants travelled to this District to

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[5] Although it is true that a foreign plaintiff's choice of forum is often accorded less deference, it is still presumptively valid and should rarely be disturbed. *See Cyberscan Tech., Inc. v. Sema Ltd.*, No. 06 Civ. 526 (GEL), 2006 U.S. Dist. LEXIS 90375, at *23-24 (S.D.N.Y. Dec. 13, 2006) (Lynch, J.) (citing *Murray v. British Broad. Corp.*, 81 F.3d 287, 290 (2d Cir. 1996) ("[S]ome weight must still be given to a foreign plaintiff's choice of forum.")); *Monegro v. Rosa*, 211 F.3d 509, 514 (9th Cir. 2000) ("[L]ess deference is not the same thing as no deference."); *Skelton Fibres Ltd. v. Canas*, No. 96 Civ. 6031 (DLC), 1997 U.S. Dist. LEXIS 2365, at *11 (S.D.N.Y. Mar. 6, 1997) ("Even with this lowered deference … this reduced weight is not an invitation to accord a foreign plaintiff's selection of an American forum no deference since dismissal for *forum non conveniens* is the exception rather than the rule.").

[6] The presence of related cases in the chosen forum weighs against dismissal. *Cromer Fin. Ltd. v. Berger*, 158 F. Supp. 2d 347, 362-63 (S.D.N.Y. 2001) (related cases in New York Supreme Court, an SEC action in the Southern District of New York, and a Trustee action in the Bankruptcy Court for the Southern District of New York all weighed against dismissal).

meet with Madoff, HC ¶¶ 63-64, 65, 77, 120, 123, 207, 234, 365, 405; PC ¶¶ 19, 34, 38, 51, 79, 80; TC ¶¶ 9, 52, 67, 71, 72-119, 138, 154, 170, 223, 241; invested Plaintiffs' money in this District, HC ¶¶ 10, 16, 20, 23, 25, 42, 46, 59, 61, 68, 70, 72-4, 79, 80, 86; PC ¶¶ 2, 5, 18-25, 22, 34, 38, 76; TC ¶¶ 7, 9, 12, 27, 67, 71, 83, 120, 154, 163, 217; performed (or more accurately, failed to perform) due diligence on Madoff in this District, HC ¶¶ 36, 63-64, 75-7, 81; PC ¶¶ 72, 135, 163, 175; TC ¶¶ 7, 74, 78, 92, 108, 109, 138, 153, 171, 215, 224, 241-43; thereby injuring Plaintiffs in this District, HC ¶¶ 67, 71, 78; PC ¶ 59; TC ¶¶ 79, 90, 98, 101, 104, 111, 118, 119-31. Additionally, Plaintiffs' legal reasons for selecting this forum were wholly legitimate, including, *inter alia*, their ability to take advantage of the class action device, *see In re Assicurazioni Generali S.p.A. Holocaust Insurance Litigation*, 228 F. Supp. 2d 348, 366 (S.D.N.Y. 2002) (availability of class action device in chosen forum weighs against dismissal); avoid costly fee shifting, *see Wesoke v. Contract Services. Ltd.*, No. 00 Civ. 1188 (CBM), 2002 U.S. Dist. LEXIS 12832, at *14 (S.D.N.Y. July 15, 2002) (avoiding fee shifting is a legitimate reason to select a U.S. forum); and their ability to pursue claims under RICO, *see Daventree Ltd. v. Republic of Azer.*, 349 F. Supp. 2d 736, 756 (S.D.N.Y. 2004) ("Public interest ordinarily favors the enforcement of federal law, such as the RICO statutes, in the United States courts[.]").

Similarly, Defendants offer no reason why this District is an inconvenient forum for them, nor could they. Indeed, Defendants travelled to New York regularly to meet with Madoff, HC ¶¶ 63-64, 65, 77, 120, 123, 207, 234, 365, 405; PC ¶¶ 19, 34, 38, 51, 79, 80; TC ¶¶ 9, 52, 67, 72-119, 138, 154, 170, 223, 241, and are hard pressed, now, to argue that making the trip to New York is somehow inconvenient.[7] Additionally, many of the Defendants are large, multi-national

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[7] *See Cyberscan*, 2006 U.S. Dist. LEXIS 90375, at *33 (fact defendant made "regular visits" to New York weighs against dismissal).

corporations – many with offices in this District – that are accustomed to litigation in the United States and have had no problem retaining counsel here.[8]

Accordingly, as this case clearly has a "*bona fide* connection" to Plaintiffs' chosen forum and Defendants have offered no reason why such choice amounts to "forum-shopping" or is otherwise inconvenient for them, Plaintiffs' choice of forum should be entitled to substantial deference. *See Pollux Holding Ltd. v. Chase Manhattan Bank*, 329 F.3d 64, 71 (2d Cir. 2003) ("Absent proof that plaintiff's choice of a U.S. forum was motivated by forum-shopping reasons, factors relating to convenience or expense generally weigh heavily in favor of the plaintiff's choice.")

B. Defendants Concede There Is No Other Forum Available

"An alternative forum is adequate if the defendants are amenable to service of process there, and if it permits litigation of the subject matter of the dispute." *Pollux,* 329 F.3d at 75. It is black letter law in this Circuit, however, that a forum is adequate only if <u>all defendants</u> are subject to jurisdiction there.[9] *PT United Can Co. v. Crown Cork & Seal Co.*, 138 F.3d 65, 73 (2d Cir. 1998); *see also ESI*, *Inc. v. Coastal Corp.*, 61 F. Supp. 2d 35, 63-64 (S.D.N.Y. 2004) (noting that "the requirement that *all* defendants remaining in the action be subject to the jurisdiction of the proposed alternative forum has since been reaffirmed by the [] Second Circuit") (citing *Jota v. Texaco*, *Inc.*, 157 F.3d 153, 159 (2d Cir. 1998)); *Odyssey Re (London) Ltd. v. Stirling Cooke Brown Holdings Ltd.*, 85 F. Supp. 2d 282, 305 (S.D.N.Y. 2000) (noting that this "may even understate Second Circuit case law, which could be read to require that all defendants be amenable to process in an alternative forum before the doctrine of *forum non conveniens* may

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[8] The parties' retention of U.S. counsel is a factor that weighs against dismissal. *See*, *e.g.*, *Bigio v. Coca-Cola Co.*, 448 F.3d 176, 180 (2d Cir. 2006); *Cyberscan*, 2006 U.S. Dist. LEXIS 90375, at *33.

[9] Should the Court conclude that it lacks jurisdiction over any Defendant, Plaintiffs are prepared to proceed in this jurisdiction without those Defendants.

even be invoked").

Here, Defendants "consent[] to jurisdiction in Ireland to determine the validity of the Thema Plaintiff's claims, and in Luxembourg to determine the validity of the Primeo and Herald Plaintiffs' claims." Def. Br. at 11-12. In neither Ireland nor Luxembourg, however, do *all* Defendants consent to jurisdiction. Indeed, two Defendants – JPM and BNY Mellon – do not consent to jurisdiction in *either* of these fora, but prefer that the case remain here in New York. *Id.* at 11. Herald SPC and EY Cayman urge the Cayman Islands as an alternative forum, but stop short of consenting to jurisdiction there, and acknowledge that certain Defendants would *not* be subject to jurisdiction there. *Id.* at 12 n.12. Accordingly, Defendants collectively concede that there is no available forum other than New York. Indeed, granting Defendants' motion on *forum non conveniens* grounds would require litigation of this case in at least two different fora – Ireland and Luxembourg – hardly promoting the efficiencies the doctrine is designed to promote. *See Concesionaria DHM*, *S.A. v. Int'l Fin. Corp.*, 307 F. Supp. 2d 553, 563 (S.D.N.Y. 2004) (denying motion to dismiss on basis of *forum non conveniens* where "granting the motion would require the plaintiff to pursue the case in two fora").[10]

Even assuming, *arguendo*, that a single forum could exercise jurisdiction over all the Defendants in this case, Defendants' proposed fora are unavailable and/or inadequate for at least the following additional reasons.

1. Ireland Is Not an Available or Adequate Forum

An Irish court could, itself, decline jurisdiction based on its own doctrine of *forum non conveniens*. J. Ryan Decl. ¶¶ 13-14. The Irish court would consider a number of factors including the fact that proceedings had been initiated in New York and that a large number of

[10] Defendants' attempt to create an available forum by urging the dismissal of JPM and BNY Mellon on the merits, moreover, *see* Def. Br. at 17, is ineffective. Even if JPM and BNY Mellon are dismissed on other grounds, there will still be no single forum where all Defendants are subject to jurisdiction.

witnesses are located there. *Id.* at ¶ 13. Also, the fact that individual actions have been commenced against the Thema Fund in Ireland would *not* weigh in favor of an Irish forum since the pleadings are not publicly available to Plaintiffs, and there is thus no way to assess whether or how Plaintiffs' claims are related to ongoing Irish proceedings. *Id.* at ¶ 13(f).

Furthermore, there is no class action device in Ireland – no lead plaintiff, no concept of the duties owed by class representatives, no ability to represent clients on a contingent basis (indeed, litigation costs must be fronted and the "loser pays"); and no potential to bind absent parties though class-wide settlement. *Id.* at ¶¶ 22-24, 48-49. An Irish court would, however, respect the judgment of a U.S. court. *Id.* at ¶ 21.

Finally, the discovery process in Ireland is very different. Third-party discovery – which would be indispensable here – is "only ordered when there is no realistic alternative available." *Id.* at ¶ 26. Likewise, an Irish court's subpoena power is limited to witnesses resident or present in Ireland. *Id.* at ¶ 27.

2. Luxembourg Is Not an Available or Adequate Forum

A Luxembourg forum would pose similar problems. Even if certain of the Defendants consented to jurisdiction in Luxembourg, a Luxembourg court would decline jurisdiction to the extent those same Defendants had consented to jurisdiction elsewhere. Molitor Decl. ¶¶ 38-39. Indeed, even within the same proceeding (with respect to the Primeo Funds, for example) a Luxembourg court would "decline jurisdiction for parts of the dispute for which other courts have jurisdiction," a situation which would "inevitably lead to fragmentation of courts' treatment of the dispute." *Id.* at ¶ 38. Similarly, a Luxembourg court would not consolidate these actions as this Court has – for pre-trial purposes or for any other purpose. *Id.* at ¶ 44. Dismissal of this case to Luxembourg would result in not one, but three separate proceedings. *Id.* Finally, the law governing a claim could depend, in any given situation, on the residence of the plaintiff, the

residence of the defendant, the choice of the parties, the place with which the contract is most closely connected (for contract claims), or the place of a plaintiff's loss (for tort claims). *Id.* at ¶¶ 52, 55. The result of transfer of this case to Luxembourg, therefore, would be "application of several different countries' laws to different claims of different plaintiffs in the Proceeding, complicating the treatment of the case and potentially leading to different results depending on the applicable law(s)." *Id.* at ¶ 56.

Like Ireland, moreover, Luxembourg has no class action device and no mechanism for a lawyer to represent a client on a contingent basis. *Id.* at ¶¶ 45, 61. In Luxembourg there is "no real equivalent to pre-trial discovery proceedings as known in common law countries," including no duty to retain documents or to provide them to one's adversary; indeed, their production may only be compelled in exceptional cases. *Id.* at ¶¶ 57-60.

3. The Cayman Islands Are Not an Available or Adequate Forum

A Cayman forum would be equally problematic. A jury trial would not be available in the Cayman Islands. Lowe Decl. ¶ 79. Discovery would be discretionary for, and could be limited by, a Cayman court. *Id.* Also, there would be no class action device and no contingent representation available to Plaintiffs in the Cayman Islands. *Id.*

* * *

Accordingly, other than New York, no single forum is available for the prosecution of this action. Even assuming that a single forum were available, moreover, each of Defendants' proposed fora are unavailable and/or inadequate for additional reasons. The Court should end its analysis here: because no other forum is available and adequate, Defendants' motion to dismiss should be denied.

C. Private and Public Interest Factors Weigh In Plaintiffs' Favor

In balancing private and public interest factors, "the plaintiff's choice of forum is to be respected unless the balance of both public and private interests strongly justifies a transfer."

Manu Int'l, *S.A. v. Avon Prods.*, *Inc.*, 641 F.2d 62, 65 (2d Cir. 1981) (citation omitted). Moreover, the action should be dismissed only if the defendant demonstrates that "the chosen forum is … genuinely inconvenient and the [alternative] forum significantly preferable." *Bigio v. Coca-Cola Co.*, 448 F.3d 176, 179 (2d Cir. 2006); *see also Iragorri*, 274 F.3d at 74-75 (same).

Even if an adequate forum were available to Plaintiffs, a variety of private and public interest factors weigh in Plaintiffs' favor, and against dismissal.

First, "[D]efendant[s'] briefs do not identify a single potential witness who would be unable or unwilling to appear in New York. This is significant, as 'such identification is generally required for a *forum non conveniens* dismissal.'" *Metito (Overseas) Ltd. v. Gen. Elec. Co.*, No. 05 Civ. 9478 (GEL), 2006 U.S. Dist. LEXIS 81683, at *16 (S.D.N.Y. Nov. 7, 2006) (Lynch, J.) (quoting *Haywin Textile Prods. v. Int'l Fin. Inv.*, 137 F. Supp. 2d 431, 436 (S.D.N.Y. 2001)). At most, Defendants argue that litigation abroad would be "easier," "less expensive," and "proceed quickly," and witnesses "more likely accessible" – not that New York would be inconvenient – and that this case should therefore be dismissed. Def. Br. at 15-16. This is not the law, and courts in this District faced with precisely the same arguments have swiftly rejected them. *See*, *e.g.*, *id.* (absence of a claim that the parties would incur "substantial hardship" by litigating in New York was unsurprising since both were "multinational companies with full access to modern transportation and telecommunications. … For many years, courts in this Circuit have recognized that modern technologies can make the location of witnesses and evidence less important to the *forum non conveniens* analysis, particularly where the parties are major corporations."); *DiRienzo v. Philip Servs. Corp.*, 294 F.3d 21, 30 (2d Cir. 2002) ("To the extent documents exist [overseas], advances in transportation and communication accord this

issue less weight." (citation omitted)).[11] Further, as Judge Lynch recognized, "modern civil litigation rarely results in a trial. … Statistically, there is a strong likelihood that neither the parties nor the witnesses they name *will ever be required to make the trip to New York*." *Cyberscan*, 2006 U.S. Dist. LEXIS 90375, at *31 (emphasis added).

Indeed, quite the opposite of what Defendants argue, the alternative they propose – namely, that this case be litigated in parallel actions in both Ireland and Luxembourg – would itself result in extreme hardship and inconvenience. Common witnesses would have to produce documents twice, sit for depositions twice, and testify at trial twice.[12] The parties would have to hire new lawyers and refile their claims in two different jurisdictions. The class action device would be unavailable to Plaintiffs, as would their ability to be represented on a contingent basis, driving up costs and resulting in the filing of "multiplicitous global litigation." *Cromer Fin. Ltd. v. Berger*, 158 F. Supp. 2d 347, 362 (S.D.N.Y. 2001); *In re Assicurazioni*, 228 F. Supp. 2d at 366 ("The almost certain unavailability of contingency fees weighs against dismissal. … The absence of a class action procedure in most European forums is also likely to drive up plaintiffs' costs as to each individual claim, a factor that weighs against dismissal."). For this reason, courts have

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[11] *See also Overseas Programming Cos. v. Cinematographische Commerz-Anstalt*, 684 F.2d 232, 232 n.1 (2d Cir. 1982) ("[A]dvances in modern telecommunications and jet travel may further circumscribe a district court's discretion in dismissing a suit on the ground of *forum non conveniens*."); *Manu Int'l*, *S.A.*, 641 F.2d at 65 (demonstrating that, as early as 1981, there was much "sentiment in [the Second] Circuit for evaluating the *forum non conveniens* factors in light of the increased speed and ease of travel and communication"); *Eclaire Advisor Ltd. v. Daewoo Eng'gs & Constr. Co.*, 375 F. Supp. 2d 257, 265 (S.D.N.Y. 2005) ("In this day and age of rapid transportation and instant communications, the convenience of immediate physical proximity to documents, testimony, and other proof has become of less consequence to a *forum non conveniens* analysis, especially when, as here, two large and sophisticated parties are involved."); *In re Assicurazioni Generali*, 228 F. Supp. 2d at 361 ("advances of modern technology … severely undercut defendants' claim of *forum non conveniens* …. The costs involved to defendants in defending this action in New York are significantly mitigated by the time- and money-saving tools including email, fax, scanners, digital photography, and global access to the internet.").

[12] It is possible in all three fora, moreover, that witnesses in the United States would not even be subject to compulsory service.

concluded that "[i]t will often be quicker and less expensive to transfer a witness or a document than to transfer a lawsuit." *Manu Int'l*, 641 F.2d at 65. Here just as in *Assicurazioni*, "[a] *forum non conveniens* dismissal would involve splitting up this consolidated action – which involves common facts and legal issues – into at least [three] different cases and moving those cases into [two] different foreign legal systems for proceedings in [two] different languages." This result is hardly consistent with the purposes of the *forum non conveniens* doctrine.

As for public factors, Defendants' assertion that the need to apply foreign law weighs in favor of dismissal, Def. Br. at 13-14, has likewise been repeatedly rejected. The Second Circuit has cautioned "against an excessive reluctance to undertake the task of deciding foreign law, a chore federal courts must often perform." *Manu Int'l*, 641 F.2d at 68; *see also Boosey & Hawkes Music Publishers*, *Ltd. v. Walt Disney Co.*, 145 F.3d 481, 492 (2d Cir. 1998).

Likewise, Defendants' assertion that overseeing this case would "unduly burden this Court," Def. Br. at 16, holds no weight. The Court's calendar may be "congested," but the "temptation in a busy district like the Southern District of New York to transfer cases … must be resisted." *Manu Int'l*, 641 F.2d at 65 (citation omitted); *see also Cromer*, 158 F. Supp. 2d at 355 ("While the docket of the Southern District is an active one, courts in this district have shown themselves more than able to address the issues that arise in complex actions in an expeditious and comprehensive manner.").

Finally, as noted above, this forum has a significant interest in redressing Defendants' wrongdoing, which ultimately arises from the roles they played in Madoff's New York-based conduct. "As courts in this Circuit have consistently recognized, 'Congress did not want to allow the United States to be used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners.'" *Terra*, 688 F. Supp. 2d at 317 (quoting *Psimenos v. E.F. Hutton & Co.*, 722 F.2d 1041, 1045 (2d Cir. 1983)).

Accordingly, Defendants have not shown that, on balance, private and public interests "strongly justify" the transfer of this action to foreign fora. This case is inherently international in scope, and the parties, witnesses and evidence are scattered throughout the world. At best, and with a stretch, Defendants' proposed fora are equally convenient as this forum. Realistically however, dismissal to those fora would unduly complicate this litigation rather than streamline it. *See Republic of Colom. v. Diageo N. Am. Inc.*, 531 F. Supp. 2d 365 (E.D.N.Y. 2007) (denying motion to dismiss where evidence was scattered throughout the United States, Columbia, the Caribbean, and Europe, and thus the proposed and instant fora were equally convenient).[13]

III. THE COURT MAY EXERCISE PERSONAL JURISDICTION OVER ALL DEFENDANTS

A plaintiff need only make a *prima facie* showing of personal jurisdiction over the defendant to defeat a Rule 12(b)(2) motion to dismiss that is filed prior to discovery. *Metro Life Ins. Co. v. Robertson-Ceco Corp.*, 84 F.3d 560, 567 (2d Cir. 1996); *Ball v. Metallurgie Hoboken-Overpelt*, *S.A.*, 902 F.2d 194, 197 (2d Cir. 1990). A plaintiff establishes a *prima facie* case by "pleading in good faith … legally sufficient allegations of jurisdiction." *Ball*¸ 902 F.2d at 197; *Centrifugal Force*, *Inc. v. Softnet Commc'n Inc.*, No. 08 Civ. 5463(CM)(GWG), 2009 WL 1059647, at *2 (S.D.N.Y. Apr. 17, 2009). Indeed, "[a]t that preliminary stage, the plaintiff's *prima facie* showing may be established solely by allegations." *Id.* In evaluating the plaintiff's *prima facie* case, the district court must construe the jurisdictional facts from the pleadings in the light most favorable to the plaintiff. *Hamilton v. Garlock*, 31 F. Supp. 2d 351, 354 (S.D.N.Y. 1999); *Bluestone Capital Partners v. MGR Funds Ltd.*, No. 98 Civ. 3128(WHP), 1999 WL 322658, at *1 (S.D.N.Y. May 20, 1999).

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[13] Defendants' assertion that "Defendants (and their documents) may be located in Switzerland, the British Virgin Islands, Austria, Italy or Luxembourg" hardly "confirms that New York is an inappropriate forum." Def Mem. at 15 n.16. Indeed, precisely the opposite is true. Defendants' concession that evidence in this case is scattered across the globe means that their proposed fora are, at best, no better than the Southern District of New York.

In appraising whether this showing has been made, "[the] Court must apply the law of New York, the state in which it sits," and "construe the pleadings and affidavits in the light most favorable to the [p]laintiff, resolving all doubts in his favor." *Jain v. T & C Holdings*, No. 10 Civ. 1006(RMB), 2011 WL 814659, at *3-4 (S.D.N.Y. Mar. 3, 2011) (Berman, J.); *see also Royal Dutch*, 226 F.3d at 95. Under New York law, a non-domiciliary is subject to personal jurisdiction if New York's long-arm statute applies and the exercise of jurisdiction comports with due process. *LaMarca v. Pak-Mor-Mfg. Co.*, 735 N.E.2d 883, 886 (N.Y. 2000).

A. Defendants Are Subject to This Court's Jurisdiction Under New York Law

New York's C.P.L.R. § 301 confers general personal jurisdiction over any non-domiciliary "transact[ing] business" in the state "so long as the cause of action arises from this conduct."[14] *Jain*, 2011 WL 814659, at *4; *see also Sole Resort*, *S.A. de C.V. v. Allure Resorts Mgmt.*, *LLC*, 450 F.3d 100, 103 (2d Cir. 2006). While such "transacted business" can be evidenced by a variety of factors including, *inter alia*, physical presence in New York, a contractual relationship with a New York domiciliary, negotiations with a party located in New York, New York bank accounts, or the exchange of money or product to or from New York, the "ultimate determination is based on the totality of the circumstances." *Sunward Elecs.*, *Inc. v. McDonald*, 362 F.3d 17, 22-23 (2d Cir. 2004). "Where a corporate subsidiary is essentially a 'separately incorporated department or instrumentality' of a foreign corporation, the activities of the subsidiaries will be attributed to the foreign parent for purposes of determining the parent's amenability to personal jurisdiction in New York." *Canterbury Belts, Ltd. v. Lane Walker*

[14] This basis for general jurisdiction is equally applicable to non-corporate entities and individuals. *See Klinghoffer v. S.N.C. Achille Lauro Ed Altri-Gestione Motonave Achille Lauro in Amministrazione Straordinaria*, 937 F.2d 44, 50 (2d Cir. 1991) ("because the form of organization by which a defendant does business is irrelevant to any policy governing acquisition of jurisdiction … we see no reason to distinguish between corporate and non-corporate [defendants] in this regard" (internal citation omitted)); *see also Moneygram Payment Sys.*, *Inc. v. Consorcio Oriental*, *S.A.*, No. 05 Civ. 10773(RMB), 2007 WL 1489806, at *3 (S.D.N.Y. May 21, 2007) (Berman, J.).

Rudkin, *Ltd.*, 869 F.2d 34, 40 (2d Cir. 1989) (citations omitted).

"[P]roof of one transaction, or a single act, in New York is sufficient to invoke long-arm jurisdiction, even though the defendant never enters New York." *Best Van Lines*, *Inc. v. Walker*, 490 F.3d 239, 248 (2d Cir. 2007) (internal quotation omitted); *see also Deutsche Bank Sec.*, *Inc. v. Mont. Bd. of Inv.*, 797 N.Y.S.2d 439, 442 (N.Y. App. Div. 2005), *aff'd*, 850 N.E.2d 1140 (N.Y. 2006); *Arch Specialty Ins. Co. v. Entm't Specialty Servs.*, *Inc*., No. 04 Civ. 1852(RCC), 2005 WL 696897, at *2 (S.D.N.Y. Mar. 24, 2005) ("A single transaction of business in the state, if done purposefully, may be sufficient to satisfy the jurisdictional requirements of Rule 302.").[15] "A cause of action arises out of a defendant's transaction of business in New York for purposes of Section 302(a)(1) when there exists an articulable nexus or a substantial relationship between transactions occurring within the state and the cause of action sued upon." *Sunward Elecs.*, 362 F.3d at 23 (internal quotation omitted); *see also Jain*, 2011 WL 814659, at *4.

Courts have held that "a non-domiciliary's contacts with New York are sufficient to confer [long-arm] jurisdiction [under Section 302(a)(1)] when it maintains an ongoing investment account in New York and conducts securities transactions through such an account." *Greenlight Capital*, *Inc. v. Greenlight (Switz.)*, No. 04 Civ. 3136(HB), 2005 WL 13682, at *3 (S.D.N.Y. Jan. 3, 2005); *see also Credit Lyonnais Sec. (USA) Inc. v. Alcantara*, 183 F.3d 151, 154 (2d Cir. 1999) (*prima facie* case for personal jurisdiction under New York's long-arm statute

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[15] *See*, *e.g.*, *Parke-Bernet Galleries*, *Inc. v. Franklyn*, 256 N.E.2d 506, 508 (N.Y. 1970) (finding jurisdiction where out-of-state defendant never entered New York, but participated in a live auction in New York by making one telephone call to New York and thus was "receiving and transmitting bids over an open telephone line"); *Fischbarg v. Doucet*, 832 N.Y.S.2d 164, 166 (N.Y. App. Div. 2007) (finding jurisdiction over out-of-state defendants who solicited New York lawyer plaintiff to provide them with legal advice and called, emailed, and faxed the plaintiff in New York pursuant to such representation, though defendants never entered the state); *Catauro v. Goldome Bank for Sav.*, 592 N.Y.S.2d 422, 422 (N.Y. App. Div. 1993) (finding jurisdiction where Missouri defendant called a New York bank with an inquiry, "mailed letters to the bank, enclosing the bankbook and the power of attorney," and thereafter received money from the bank).

established when defendant had active account in New York and plaintiff's lawsuit was based on transactions in that account); *Picard v. Elbaum*, 707 F. Supp. 144, 146 (S.D.N.Y. 1989) (asserting long-arm jurisdiction over defendants who never physically entered New York, but maintained an ongoing investment account with a New York investment service and made at least three transactions during a two-year period); *Rothschild v. Thompson*, 433 N.Y.S.2d 6 (N.Y. App. Div. 1980) (finding long-arm jurisdiction over defendant who managed securities account through contacts with broker in New York). Particularly "if … the account in question played a role in the activities giving rise to the cause of action, specific [long-arm] jurisdiction under N.Y. C.P.L.R. § 302(a) may be proper." *Steinberg v. A Analyst Ltd.*, No. 04-60898, 2009 WL 806780, at *5 (S.D. Fla. Mar. 26, 2009) (applying New York law).

Moreover, where jurisdiction over a foreign corporation is at issue, "activities that satisfy the requirement of doing business do not necessarily need to be conducted by the foreign corporation itself." *Royal Dutch*, 226 F.3d at 95. "Under well-established New York law, a court of New York may assert jurisdiction over a foreign corporation when it affiliates itself with a New York representative entity and that New York representative renders services on behalf of the foreign corporation that … are sufficiently important to the foreign entity that the corporation itself would perform equivalent services if no agent were available."[16] *Id.*; *Klinghoffer v. S.N.C. Achille Lauro Ed Altri-Gestione Motonave Achille Lauro in Amministrazione Straordinaria*, 937 F.2d 44, 50 (2d Cir. 1991); *see also Tese-Milner v. De Beers Centenary A.G.*, 613 F. Supp. 2d 404, 415 (S.D.N.Y. 2009). "To come within the rule, a plaintiff need demonstrate neither a formal agency agreement ... nor that the defendant exercised direct control over its putative agent." *Royal Dutch*, 226 F.3d at 95 (internal citations omitted).

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[16] *See*, *e.g.*, *Frummer v. Hilton Hotels Int'l Inc.*, 227 N.E.2d 851, 853-54 (N.Y. 1967) (finding jurisdiction over foreign hotel chain based on the activities of affiliated reservations service); *Gelfand v. Tanner Motor Tours*, *Ltd.*, 385 F.2d 116, 120-21 (2d Cir. 1967) (applying *Frummer* to find jurisdiction over tour operator based on the activities of affiliated travel agent).

In light of these standards and Plaintiffs' well-pled allegations, the Personal Jurisdiction Defendants' arguments are unavailing. The sole purpose of each Fund was to transfer money received from Fund investors to BLMIS' bank accounts in this District. Then, BLMIS would periodically inform each Fund of phony gains. In turn, the Funds would claim to investors they earned a percentage of those phony gains. The Funds would take that percentage out of BLMIS' bank accounts in this District, and divide it among themselves and various Defendants.

Kohn has had continuous contacts with New York since the 1980s. TC ¶ 72. She maintained a residence in Monsey, New York. *Id.* Kohn established and controlled New York companies that are critical members of the scheme, including Medici Fund Management, Medici Finance Services, Eurovaleur, Infovaleur, Erko, and Windsor. HC ¶ 25. Eurovaleur registered the "Primeo" trademark in New York. PC ¶¶ 19-20.

Kohn entered into agreements with Madoff in New York to provide Fund investors to BLMIS. HC ¶ 55. Kohn was also Bank Medici's founder, chairperson, and 75% owner. HC ¶ 63. Bank Medici claimed it had offices in New York. HC ¶ 62. Madoff met with Bank Medici executives in New York. HC ¶ 63. Kohn, Bank Austria, and UCG fed Madoff's Ponzi scheme via a New York bank account and drew kickbacks from that and other Madoff New York accounts. PC ¶ 23.

HSBC Bank USA has offices in New York. TC ¶ 40; PC ¶ 50. The HSBC Defendants transacted business in New York in connection with their roles as custodian and administrator. *See*, *e.g.*, TC ¶ 109. The HSBC Defendants consistently wired monies, for the benefit of the Funds, directly into BLMIS' account at JPM in New York. PC ¶ 48. HSBC Bank USA received subscription payments from Plaintiffs to be invested in the Funds. PC ¶¶ 49-50. Additionally, an HSBC representative met with Madoff on at least two occasions at BLMIS's New York office in connection with HSBC's custodial services. TC ¶ 108. The HSBC Defendants not only

participated in funneling Fund assets to Madoff and BLMIS, but also appointed Madoff and BLMIS in New York to serve as Thema's sub-custodian. TC ¶ 105. Like the HSBC Defendants, the PwC Defendants – PwC Ireland, PwC U.S., PwC Bermuda, and PwCIL – met numerous times with Madoff in New York through their representatives. TC ¶¶ 114-15, 117. In addition, the PwC Defendants have had substantial contacts with the United States through, among other things, regular visits and receipts of payments. *See* TC ¶ 116.

PGAM has offices in New York City. PC ¶ 24. E&Y has offices in New York City. HC ¶ 62. Additionally, Bank Austria had offices located at 150 E. 42nd Street in New York City. *Id.* Zapotocky, on behalf of Bank Austria, traveled to New York two to three times a year to meet with Madoff. HC ¶ 120. His responsibilities included creation of the Primeo Funds, and overseeing Bank Austria's direct account with BLMIS. *Id.* He also served as a director of the Primeo Funds and Alpha Prime Fund. *Id.* UCG operates a New York branch, holds assets and properties in New York, registered its common stock to trade on exchanges in New York, and operated, directed and controlled numerous subsidiaries and affiliates incorporated and/or doing business in New York, each of which shares an address with UCG's New York branch. TC ¶¶ 88-89; PC ¶ 21. UCG also assigned a member of its management to live in the United States. TC ¶ 87. He was also the CEO of PGAM and involved in UCG's handling of the Funds. *Id.*

Radel-Leszczynski was a director of the Primeo Funds and President of BA Worldwide. PC ¶ 34. As President of BA Worldwide and an employee of Bank Austria, Radel-Leszczynski caused BLMIS accounts to be opened in New York on behalf of Bank Austria and BA Worldwide. *Id.* Radel-Leszczynski also caused proceeds of Madoff's Ponzi scheme to be both sent to and received from accounts in New York. PC ¶ 34.

Beginning with the 1993 launch of the Primeo Funds, Kohn, Zapotocky, Radel-Lezczynski, Kretschmer, and Hemetsberger traveled to New York, personally and on behalf of

Bank Medici, Bank Austria, and BA Worldwide, to meet with Madoff at BLMIS to discuss the Funds. HC ¶ 234. Similar meetings continued two to three times a year for the next fifteen years. *Id.* After UCG took over Bank Austria, the meetings continued and Radel-Leszczynski acted as UCG's agent. TC ¶ 86. How to best market the Funds was the topic of these meetings with Madoff. HC ¶ 234.

Also during these visits, Kohn, Zapotocky, Kretschmer, Hemetsberger, and Radel-Leszczynski traveled to Bank Austria's New York branch. HC ¶ 235. Kohn facilitated these travels through Eurovaleur in New York. *Id.*

A. and S. Benbassat also each met with Madoff in New York to conduct Thema Fund business. TC ¶¶ 92, 96. The Benbassats and Smith were Thema directors, Thema Asset Management Ltd. directors and partners in GB&C. TC ¶¶ 29, 30, 31. Brady and Morrissey were also Thema directors. TC ¶¶ 33-35.

Kaniak, Tiefenbacher, Spalek, and Wheaton were all directors of the Primeo Funds. PC ¶¶ 27-29, 36. Fielding was a director of Primeo and General Manager of Global Fund Services for Bank of Bermuda (Luxembourg) S.A., one of the Funds' custodians. PC ¶ 30. Simon was President and CEO of Primeo and General Manager of the Financial Products Department of Bank Austria. PC ¶ 26. La Rocca was a Primeo director, Managing Director of Pioneer Alternative Investment Management (Bermuda) Limited, a PGAM director, and CEO of PIM. PC ¶ 32. Murray was a Primeo director and COO of PIM. PC ¶ 33. Saleta was a Primeo director, Herald (USA) director, and BA Worldwide director. PC ¶ 35; HC ¶ 21.

Mugnai, a director of the Herald Funds, signed Herald Funds' BLMIS account opening documents and caused proceeds of Madoff's Ponzi scheme to be both sent to and received from accounts at JPM in New York City. HC ¶ 18. Pfeffer was, at all relevant times, a director of the Herald Funds. HC ¶ 17. The Herald Funds, S. Kohn, Pfeffer, Saleta, and Mugnai each knew

that the Herald Funds were formed with the sole purpose of supplying investors' funds to Madoff in this District. HC ¶¶ 574, 580.

Because the Funds have no employees and were entirely controlled by their directors, their contacts with and conduct in New York are attributable to the Funds. TC ¶¶ 27, 91-101. In the same vein, Thema and GB&C are subject to the personal jurisdiction of this Court. *Id.* Moreover, each Defendant's misconduct and contacts with New York are attributable to the other Defendants because they aided and abetted, encouraged, and rendered substantial assistance to the other Defendants in breaching their obligations to Plaintiffs and the classes. TC ¶ 63; HC ¶¶ 377, 796-818.

B. Due Process Concerns Do Not Preclude Jurisdiction

"So long as a party avails itself of the benefits of the forum, has sufficient minimum contacts with it, and should reasonably expect to defend its actions there, due process is not offended if that party is subjected to jurisdiction even if not present in that State." *Kreutter v. McFadden Oil Corp.*, 71 N.Y.2d 460, 466 (N.Y. 1988). Because Plaintiffs have amply alleged sufficient contacts by Defendants, and because Defendants fail to raise any compelling fairness concerns, due process is not offended here.

The Complaints are replete with fact-specific allegations demonstrating the requisite contacts by Defendants. *See*, *e.g.*, HC ¶¶ 25, 55; PC ¶¶ 19-22, 24, 34, 48-50; TC ¶¶ 72-119. New York courts consistently find much more attenuated non-domiciliary contacts to comport with due process. *See*, *e.g.*, *Deutsche Bank Sec., Inc. v. Montana Bd. of Inv.*, 7 N.Y.3d 65, 71-72 (N.Y. 2006) (personal jurisdiction found over Montana corporation where corporate representatives, solely through phone calls and emails, executed bond purchases with financial professionals in New York); *Kreutter*, 71 N.Y.2d at 470-72 (finding personal jurisdiction over a Texas resident who acted solely in Texas, but whose actions were part of an overall scheme to

defraud in New York); *CIBC Mellon Trust Co. v. HSBC Guyerzeller Bank AG*, 56 A.D.3d 307, 308-09 (N.Y. App. Div. 2008) (foreign corporate defendant subject to personal jurisdiction in New York because its agents participated in a fraudulent conveyance in New York); *Banco Nacional Ultramarino, S.A. v. Chan*, 169 Misc. 2d 182, 182-83 (N.Y. Sup. Ct. 1996) ("to allow a defendant to [contribute to] tortious activities in New York ... and then avoid jurisdiction because it directs those activities from outside the state or country, is to ignore the reality of modern banking").

Defendants' invocation of "fair play and substantial justice" is meritless. Def. Br. at 10. To contest jurisdiction on these grounds, "defendant[s] must come forward with a compelling case that ... would render jurisdiction unreasonable." *Royal Dutch*, 226 F.3d at 99 (internal quotation omitted). The only burden Defendants purport to bear – having to defend themselves "thousands of miles from home" – is far from compelling. Def. Br. at 10. Indeed, the Second Circuit has found such concerns negligible:

> While it is true that certain factors normally used to assess the reasonableness of subjection to jurisdiction do favor the defendants (they are foreign corporations that face something of a burden if they litigate here, and the events in question did not occur in New York), litigation in New York City would not represent any great inconvenience to the defendants. The defendants control a vast, wealthy, and far-flung business empire which operates in most parts of the globe. They ... have access to enormous resources, face little or no language barrier, have litigated in this country on previous occasions, have a [] long relationship with [some] of the nation's leading law firms, and [several are] parent companies of [large American] corporations, which ha[ve] a very significant presence in New York. New York City, furthermore, where the trial would be held, is a major world capital which offers central location, easy access, and extensive facilities of all kinds. We conclude that the inconvenience to the defendants involved in litigating in New York City would not be great and that nothing in the Due Process Clause precludes New York from exercising jurisdiction over the defendants.

Royal Dutch, 226 F.3d at 99. Likewise, here, nothing in the due process clause precludes jurisdiction over Defendants.

IV. PLAINTIFFS ADEQUATELY ALLEGE COMMON LAW CLAIMS AGAINST ALL DEFENDANTS

A. New York Law Applies to Plaintiffs' Common Law Claims

1. New York Law is Applicable as No Genuine Conflict Exists Between New York and the Relevant Foreign Jurisdictions

This Court should apply New York law as there is no genuine conflict between New York law and the law of Ireland, Luxembourg, or the Cayman Islands with respect to any particular legal issue or claim. Indeed, a federal court in a diversity case applies the conflict of law principles of the forum state. *See Globalnet Financial.com, Inc. v. Frank Crystal & Co.,* 449 F.3d 377, 382 (2d Cir. 2006). A conflicts analysis is unnecessary if there is no substantive conflict between New York law and the law of the foreign jurisdiction in question. *See id.; see also Int'l Bus. Machines Corp. v Liberty Mut. Ins. Co.,* 363 F.3d 137, 143-44 (2d Cir. 2004). In the absence of a substantive conflict, the court may apply New York law.

As demonstrated by the declarations proffered by Plaintiffs' Cayman, Irish and Luxembourgian experts regarding each separate claim, no substantial conflict exists between each of those foreign jurisdictions and the law of New York. *See Globalnet,* 449 F.3d at 38; *see, e.g.*, Lowe Decl. ¶¶ 50-78; J. Ryan Decl. ¶¶ 43-47; Molitor Decl. ¶¶ 63-130. Accordingly, it is appropriate for this Court to apply New York law. Moreover, New York has the most significant interest in this litigation, and for that reason alone it is appropriate to apply New York law.

2. New York Has the Most Signficant Interest In This Litigation

New York choice-of-law rules apply to these consolidated actions because this Court is located in New York. *See AroChem Int'l*, *Inc. v. Buirkle*, 968 F.2d 266, 269-70 (2d Cir. 1992) (citing *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487, 496 (1941)).[17] Under New York law,

[17] HSBC's arguments that "some" or "certain" of the Herald Lux and Primeo Fund shareholders signed subscription agreements specifying that particular law should govern is not dispositive to this issue. Def. Br. at 30. Contractual choice-of-law provisions generally do not govern non-contractual causes of action, such as the majority of the ones alleged by Plaintiffs

this Court must apply the laws of the jurisdiction with the "greatest interest" in the litigation. *See*, *e.g.*, *PPI Enters. (U.S.), Inc. v. Del Monte Foods Co.*, No. 99 Civ. 3794(BSJ), 2003 WL 22118977, at *17 (S.D.N.Y. Sept. 11, 2003); *Roselink Investors*, *L.L.C. v. Shenkman*, 386 F. Supp. 2d 209, 225 (S.D.N.Y. 2004). As alleged in the Complaints, Defendants' tortious conduct in managing the funds (or, more accurately, in failing to manage the Funds) occurred in New York. *See*, *e.g.*, HC ¶¶ 64, 67-68, 234, 236, 288, 331; PC ¶¶ 2, 79, 89, 153; TC ¶¶ 83, 86, 103, 105, 108-09. Indeed, while it is more than arguable that no one actually managed the Funds (even though certain of the Defendants clearly had a duty to do so), any management that *did* occur took place in New York because Defendants ceded all authority to Madoff. *See*, *e.g.*, HC ¶¶ 231, 544; PC ¶ 78; TC ¶¶ 12, 83, 94, 135, 141, 152, 173, 214, 222, 231, 391.

Moreover, as alleged in the Complaints, all information concerning the Funds, which Defendants failed to verify, issued from Madoff in New York. *See*, *e.g.*, *Pension Comm. of the Univ. of Montreal Pension Plan v. Banc of Am. Sec. LLC*, 446 F. Supp. 2d 163, 194 (S.D.N.Y. 2006) (applying New York law to breach of fiduciary duty as "New York has a strong interest in applying its law with respect to defendants who aid and abet torts masterminded and executed by hedge fund managers from within the state, and who breach their fiduciary duties, to serve as a check against such misconduct," and because "the breach of fiduciary duty relates to the [] Defendants' failure to independently verify false information issued to them from" the hedge fund managers).

Further, where, as here, "a number of countries have limited and dispersed contacts with the fraud, the Court should apply New York law as the jurisdiction where the fraud originated and where substantial activities in furtherance of the fraud were committed." *Cromer Fin. v.*

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here. *See Rosenberg v. Pillsbury Co.*, 718 F. Supp. 1146, 1150 (S.D.N.Y. 1989); *Fin. One Pub. Co. v. Lehman Bros. Special Fin.*, *Inc.*, 414 F.3d 325, 335 (2d Cir. 2005) ("Under New York law … tort claims are outside the scope of contractual choice-of-law provisions that specify what law governs construction of the terms of the contract….").

Berger, 137 F. Supp. 2d 452, 492-93 (S.D.N.Y. 2001). Moreover, as outlined *supra*, Section IV.A.2., this is the *only Court* with an interest in the whole case and jurisdiction over all Defendants.

B. Plaintiffs Have Sufficiently Pled Violations of New York Common Law

1. This Court Should Sustain Plaintiffs' Negligence Allegations

Each of the Plaintiffs has properly pled causes of action for negligence and gross negligence. The Primeo Plaintiffs have also sufficiently pled a claim for negligent misrepresentation and the Thema Plaintiffs have sufficiently pled their additional claims for professional negligence, aiding and abetting negligence and gross negligence, and related derivative claims.[18] *See* HC C 5-6, 10-12, 14-15; PC C 2-3, 8-9, 11, 13-14, 16-17, 20, 22, 24, 26; TC C 1-12. To survive Defendants' motion, Plaintiffs need only satisfy the pleading requirements of Fed. R. Civ. P. 8(a). *See*, *e.g.*, *Rombach v. Chang*, 355 F.3d 164 (2d Cir. 2004); *supra*, Section I. As set forth below, Plaintiffs' negligence-based claims easily meet that standard.

a. Negligence

To plead their claims for negligence, Plaintiffs allege (1) duty; (2) breach of that duty; and (3) damages proximately caused by that breach. *S.H. and Helen R. Scheuer Family Found. v. 61 Assocs.*, 582 N.Y.S.2d 662, 666 (N.Y. App. Div. 1992) (actionable negligence claim against investment advisor who "negligently selected, supervised, and monitored [Defendant] as its delegee with the authority to invest, reinvest, and manage the funds of the Foundation"); *Rabalais v. Starrett City*, *Inc.*, No. 16811/08, 2010 WL 3463730, at *2 (N.Y. Sup. Ct. Aug. 30, 2010). Nothing more is required, and Plaintiffs' extensive allegations more than satisfy these

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[18] Plaintiffs address the Thema Plaintiffs' derivative claims at Section V, *infra*.

elements.[19]

Plaintiffs allege that each of the Defendants had a duty resulting from their special relationships with Plaintiffs to exercise due care in the management of the assets invested in each of the Funds; in the selection and monitoring of the sub-manager, Madoff; and/or in the auditing of the Funds. *See*, *e.g.*, HC ¶¶ 542-43, 576, 683-84, 721, 758-59; PC ¶¶ 224-25, 268-69, 304-05; 327-28; TC ¶¶ 159, 300, 320, 427-28, 476-77, 482-83. Indeed, Defendants charged with negligence include the Funds themselves, along with the Funds' directors, advisers and sub-advisers, custodians, administrators, investment managers, and auditors. *See* HC C 6, 11, 12, 15; PC C 3, 9, 11, 14-17; TC C 1-4, 7-8.

b. Gross Negligence

Gross negligence is an "extreme departure from the standards of ordinary care." *AMW Materials Testing*, *Inc. v. Town of Babylon*, 584 F.3d 436, 454 (2d Cir. 2009); *Colnaghi*, *U.S.A.*, *Ltd v. Jewelers Protection Servs.*, *Ltd.*, 611 N.E.2d 282, 284 (N.Y. 1993) (gross negligence evinces "a reckless disregard for the rights of others"); *AT&T v. City of New York*, 83 F.3d 549, 556 (2d Cir. 1996) (to be liable for gross negligence, defendants must have made errors or omissions that constitute a "gross failure to exercise due care")

[19] Contrary to BNY Mellon's arguments, *see* Liman Decl. at 3, there is nothing "contradictory" about a claim of aiding and abetting negligence. Plainly, just as a party may knowingly facilitate another's intentional tort, a party can knowingly facilitate another's negligence. While the aider must have actual knowledge that he is aiding, that requirement has no bearing on the primary tortfeasor's negligence. These are distinct legal elements, distinct mental states applicable to distinct parties, and entirely congruent in theory and practice. Not surprisingly, numerous courts, in New York and beyond, have acknowledged the soundness of such claims. *See, e.g.*, *Lindsay v. Lockwood,* 625 N.Y.S.2d 393, 397 (N.Y. Sup. Ct. 1994) (describing aiding and abetting negligence as "archetypical" aiding and abetting tort); *Herman v. Westgate*, 464 N.Y.S.2d 315, 316 (N.Y. App. Div. 1983) (recognizing aiding and abetting negligence); *Winslow v. Brown,* 371 N.W.2d 417, 421-22 (Wis. 1985) ("we conclude that a person may aid and abet a negligent tort"); *State ex rel. Mays v. Ridenhour,* 811 P.2d 1220, 1232 (Kan. 1991); *Price v. Halstead,* 355 S.E.2d 380, 386 (W. Va. 1987) (same); *Cobb v. Indian Springs, Inc.*, 522 S.W.2d 383, 388-89 (Ark. 1975) (same).

In addition to the Plaintiffs' negligence allegations outlined *supra*, Plaintiffs' relevant Counts allege, *inter alia*, that Defendants grossly failed to: exercise the degree of prudence, caution, and good business practice that would be expected of any reasonable investment professional; perform necessary and adequate due diligence before investing in Madoff; monitor Madoff on an ongoing basis to any reasonable degree; take adequate steps to confirm Madoff's purported account statements, transactions and holdings of the Funds; take reasonable steps to ensure that the investments of the assets of Plaintiffs and the classes were made and maintained in a prudent and professional manner; take reasonable steps to preserve the value of Plaintiffs' and the classes' investments; and/or exercise generally the degree of prudence, caution, and good business practices that would be expected of any reasonable investment professional. Moreover, Plaintiffs allege that Defendants ignored a substantial number of red flags indicating that BLMIS was a Ponzi scheme in order to receive benefits for themselves. *See* HC ¶¶ 3, 5, 54, 430-85, 488-510, 551-67, 576, 578, 582, 585-86, 606-13, 615-16, 622-27; PC ¶¶ 4, 11, 72, 136-45, 152-54, 156-67, 168-92; TC ¶¶ 10, 12, 137-40, 144-46, 152-56, 158-86, 192-208, 215, 221-23, 227-29, 242, 246, 263, 275-76, 286, 319, 323-34, 339-50, 352, 359-60, 363, 369-385. All the while, Defendants benefited from Madoff's crimes. *See*, *e.g.*, HC ¶¶ 2, 66, 197-207, 222, 240-41, 328-29; PC ¶¶ 3, 6, 8, 20, 73, 76, 81, 84, 88, 95, 109, 149, 154; TC ¶¶ 11, 16, 19, 50, 52, 154, 156, 302-05, 320.

c. Negligent Misrepresentation

The Primeo Complaint properly states causes of action for negligent misrepresentation against PGAM, the Primeo Funds, the Primeo Director Defendants, the Primeo E&Y Defendants,[20] the Primeo Administrator and the Primeo Custodians, as defined therein (collectively, the "NM Defendants"). *See* PC C 20, 22, 24, 26. To state a negligent

[20] The claims concerning the E&Y Defendants are discussed in depth *infra* at Section IV.C.1.

misrepresentation claim, a plaintiff must allege that: (1) the defendant had a duty, as a result of a special relationship, to give correct information; (2) the defendant made a false representation that he or she should have known was incorrect; (3) the information supplied in the representation was known by the defendant to be desired by the plaintiff for a serious purpose; (4) the plaintiff intended to rely and act upon it; and (5) the plaintiff reasonably relied on it to his or her detriment. *Hydro Investors*, *Inc. v. Trafalgar Power, Inc.*, 227 F.3d 8, 20 (2d Cir. 2000); *see also Healthcare Fin. Group, Inc. v. Bank Leumi USA*, 669 F. Supp. 2d 344, 347 (S.D.N.Y. 2009) (Marrero, J.) (same). The Primeo Plaintiffs' allegations more than satisfy these elements.

The Primeo Plaintiffs allege that: (1) the NM Defendants and the Primeo Plaintiffs had a special relationship, as the NM Defendants placed themselves in a position of trust with respect to the Primeo Plaintiffs by representing their special expertise with respect to investments generally and the Funds specifically;[21] (2) the NM Defendants failed to properly inform investors about the selection and scrutiny (or lack of scrutiny) of investment managers for the Primeo Funds and the Funds' true financial condition; (3) the information supplied to the Primeo Plaintiffs was known by the NM Defendants to be desired by them for a serious purpose, namely their decision whether to invest in the Funds; (4) the Primeo Plaintiffs intended to rely on the representations regarding the Funds and as a result invested in and/or retained their investments

[21] "[T]he standard of a special relationship in the context of a negligent misrepresentation claim is less rigorous than that of a fiduciary duty" claim. *Musalli Factory for Gold & Jewellry v. JPMorgan Chase Bank*, *N.A.*, 261 F.R.D. 13, 28 (S.D.N.Y. 2009). Where a defendant seeks to "induce plaintiffs to invest" by holding itself out as possessing "unique or specialized expertise" it occupies "a special position of confidence and trust with [respect to] the injured party such that reliance on the negligent misrepresentation is justified." *Kimmell v. Schaefer*, 675 N.E.2d 450, 454 (N.Y. 1996) (finding special relationship where defendant corporate chairman and CFO induced plaintiffs' investment based on financial projections that he created). *See also Muller-Paisner v. TIAA*, 289 Fed. Appx. 461, 466 (2d Cir. 2008) (finding a special relationship for purposes of a negligent misrepresentation claim where defendant represented in marketing materials that their investment products were backed by considerable infrastructure); *Century Pac., Inc. v. Hilton Hotels Corp.*, 528 F. Supp. 2d 206, 232 (S.D.N.Y. 2007) (special relationship exists where "defendants sought to induce" plaintiffs to purchase by making statements or providing information that the plaintiffs would rely upon).

in the Primeo Funds; and (5) the Primeo Plaintiffs reasonably relied on the NM Defendants' representations regarding the Primeo Funds to their substantial detriment. PC C 20, 22, 24, 26.

2. Plaintiffs Have Sufficiently Alleged Certain Defendants Breached Their Fiduciary Duties and Other Defendants Aided and Abetted Those Breaches

a. Breach of Fiduciary Duty

Plaintiffs assert valid claims for certain Defendants' breaches of fiduciary duty and against other Defendants for aiding and abetting those breaches.[22] Under New York law, a claim for breach of fiduciary duty requires: (1) the existence of a fiduciary duty between the parties, (2) a breach of that duty; and (3) damages resulting from that breach. *Pension Comm.*, 446 F. Supp. 2d at 196-98. A breach may be found in any case "in which influence has been acquired and abused, in which confidence has been reposed and betrayed." *United Feature Syndicate*, *Inc. v. Miller Features Syndicate*, *Inc.*, 216 F. Supp. 2d 198, 218 (S.D.N.Y. 2002) (quoting *Penato v. George*, 383 N.Y.S.2d 900, 904 (N.Y. App. Div. 1976)).

Claims alleging a breach of a duty of care, disclosure, or loyalty are subject to the general pleading standards set out in Fed. R. Civ. P. 8(a), not the heightened standards of Rule 9(b), even if the same complaint contains fraud claims. *Rahl v. Bande*, 328 B.R. 387, 413 (Bankr. S.D.N.Y. 2005). Moreover, "New York courts generally avoid dismissing a claim of breach of fiduciary duty … because it usually involves a question of fact: whether someone reposed trust and

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[22] The Herald Complaint asserts claims for breaches of fiduciary duty owed to Plaintiffs and the proposed class against the Herald Funds, HAML, the Herald Medici Defendants, the Herald Director Defendants and HSBC Luxembourg, and claims against all Defendants for aiding and abetting those breaches. *See*, *e.g.*, HC C 4, 13, 18. The Primeo Complaint asserts claims for breaches of fiduciary duty against the Primeo Medici Defendants, PGAM, the Primeo Funds, the Primeo Director Defendants, the Primeo Administrator, and the Primeo Custodians, and against EYG and EY Cayman for aiding and abetting those breaches. *See*, *e.g.*, PC C 1, 10-12, 15. The Thema Complaint asserts direct and derivative claims for breaches of fiduciary duty against the Thema Medici Defendants, the Thema Director Defendants, HTIE, HSSI, and the Thema Advisor Defendants, and against all Defendants for aiding and abetting those breaches. *See*, *e.g.*, TC C 13-16. The defendants whom Plaintiffs allege breached their fiduciary duties are collectively referred to herein as the "Fiduciary Defendants."

confidence in another who thereby gains a resulting superiority or influence." *Musalli Factory*, 261 F.R.D. at 26; *see also Abercrombie v. Andrew Coll.*, 438 F. Supp. 2d 243, 274 (S.D.N.Y. 2006) (whether a fiduciary duty exists "normally depends on the facts of a particular relationship, [and] therefore a claim alleging the existence of a fiduciary duty is not subject to dismissal").

In this case, the Complaints plead that each of the Fiduciary Defendants owed the respective Plaintiffs a fiduciary duty (*e.g.*, HC ¶¶ 22, 53, 662-66, 736-44; PC ¶¶ 56, 114, 203-07; TC ¶¶ 157, 161, 209, 504-06), which they ignored (*e.g.*, HC ¶¶ 667, 745; PC ¶ 208; TC ¶¶ 78, 146, 507), resulting in damage to the Plaintiffs and other members of the classes (*e.g.*, HC ¶¶ 668-72, 746; PC ¶¶ 209-13; TC ¶¶ 508-09). Indeed, as alleged in the Complaints, the Fiduciary Defendants each held themselves out to Plaintiffs as, *inter alia*, (i) possessing the necessary expertise to monitor the Madoff investments; and (ii) being actively engaged in such monitoring. Relying on these representations, Plaintiffs entrusted their investments to the Fiduciary Defendants. Rather than exercising due care and loyalty with respect to Plaintiffs and their investments, the Fiduciary Defendants entirely disregarded and abdicated those responsibilities. *See*, *e.g.*, HC ¶¶ 667, 745; PC ¶ 208; TC ¶¶ 78, 146, 507.

One New York state court recently refused to dismiss a civil complaint against, *inter alia*, a Madoff feeder fund manager who allegedly "turn[ed] over the funds to Madoff without conducting adequate due diligence, despite information given to [him] by his own associates, as well as some of the funds' investors, indicating that Madoff may have been engaged in misconduct." *People v. Merkin*, No. 450879/09, 2010 NY Slip Op 50430U, at *9 (N.Y. Sup. Ct. Feb. 8, 2010). In *Merkin* the government alleged, as Plaintiffs have here, that the feeder fund manager "was aware of certain aspects of Madoff's operations that raised the possibility of fraud by Madoff, including Madoff's use of paper trade confirmations, the secrecy of Madoff's

operations, the fact that Madoff was self-clearing, and that his operations were controlled exclusively by himself and close family members [], … Merkin never questioned Madoff's operations." *Id.* According to the court, the manager "had fiduciary duties to his investors." *Id.* at *11 ("The relationship created by the Offering Documents imposed on Merkin a duty to act with care and loyalty independent of the terms of those agreements."); *see also Rolf v. Blyth*, 570 F.2d 38, 45 (2d Cir. 1978); *Rasmussen v. A.C.T. Envtl. Servs.*, 739 N.Y.S.2d 220, 222 (N.Y. App. Div. 2002).

As Plaintiffs here have likewise pled the elements of their claims for breach of fiduciary duty, Defendants' motion to dismiss those claims should be denied.

b. Aiding and Abetting the Breaches

Plaintiffs have also asserted valid claims for Defendants' alleged aiding and abetting of the Fiduciary Defendants' breaches. 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)).

The actual knowledge requirement is satisfied where there is sufficient circumstantial evidence to give rise to an inference of knowledge. *Pension Comm. of the Univ. of Montreal Pension Plan v. Banc of Am. Sec. LLC*, No. 05 Civ. 9016(SAS), 2007 WL 528703, at *7 (S.D.N.Y. Feb. 20, 2007) (denying 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).[23] Moreover, it is sufficient to allege willful blindness or conscious avoidance to satisfy the knowledge element. *See Cromer Fin. Ltd. v. Berger*, No. 00 Civ. 2284DLC, 2003 WL 21436164, at *9 (S.D.N.Y. June 23, 2003).

Plaintiffs allege that Defendants 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. *See*, *e.g.*, HC ¶¶ 3, 5, 54, 430-85, 488-510, 551-67, 576, 578, 582, 585-86, 606-13, 615-16, 622-27; PC ¶¶ 4, 11, 72, 136-45, 152-54, 156-67, 168-92; TC ¶¶ 10, 12, 137-40, 144-46, 152-56, 158-86, 192-208, 215, 221-23, 227-29, 242, 246, 263, 275-76, 286, 319, 323-34, 339-50, 352, 359-60, 363, 369-85.

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 the Fiduciary Defendants' breaches were substantially assisted by the other Defendants which, *inter alia*, issued clean audit opinions (*e.g.*, HC ¶¶ 521-50; PC ¶¶ 9, 104-35; TC ¶¶ 247-301); violated federal banking regulations and assisted in laundering of funds to Madoff (*e.g.*, HC ¶¶ 460-85; TC ¶¶ 313-48); failed to exercise their custodial duties (*e.g.*, HC ¶¶ 505-10; PC ¶¶ 151-55; TC ¶¶ 104, 108, 143, 162-73, 306); and failed to exercise their directorial duties (*e.g.*, HC, PC, TC, *passim*). Indeed, without each of these acts, it is highly unlikely that Madoff would have been able to perpetrate his fraud throughout the class periods,

[23] At summary judgment, the same court found a question of fact existed because a jury could find that the fund's prime broker/custodian 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 Comm. of the Univ. of Montreal Pension Plan v. Banc of Am. Sec.*, *LLC*, 652 F. Supp. 2d 495, 510 (S.D.N.Y. 2009).

particularly because Madoff would not have had the funds to commit his fraud without the active assistance of the other Defendants.

Contrary to the JPM Defendants' assertions, Hynes Decl. at 2-4, "allegations that, among other things, [they] … approved certain transactions [that] mask[ed] the [F]und[s'] financial problems, [are] sufficient to plead the requisite knowledge and substantial assistance necessary to state a cause of action for aiding and abetting breach of fiduciary duty." *Balance Return Fund Ltd. v. Royal Bank of Canada*, 921 N.Y.S.2d 38, 40 (N.Y. App. Div. 2011). JPM not only approved transactions that masked the Funds' financial problems, but its conduct concealed and perpetuated Madoff's fraud. TC ¶¶ 312-57. Moreover, the Complaints allege that JPM managed accounts that existed to launder monies obtained from investors and funneled to Madoff, maintained grossly inadequate internal controls, turned a blind eye to glaring irregularities in the accounts maintained for Madoff, and went so far as to sell structured notes derivative of the Funds despite severe suspicions that Madoff was operating an underlying fraud. *Id.* Creating, marketing, and profiting from derivatives of a Ponzi scheme certainly constitutes more than "routine banking services." *Cf.* Hynes Decl. at 5. Despite JPM's attempts to downplay its egregious lapses, the Complaints' allegations more than suffice. *See Anwar v. Fairfield Greenwich Ltd.*, 728 F. Supp. 2d 372, 443 (S.D.N.Y. 2010) ("*Anwar II*").

Similarly, the Thema Plaintiffs have adequately pled that William Fry aided and abetted breaches of fiduciary duty. Plaintiffs have alleged that William Fry knew the numerous agreements it prepared and reviewed between and among the Thema Fund, Madoff, and the other Defendants, *inter alia*, "posed irreconcilable and unacceptable conflicts of interest," concealed Defendants' dealings with Madoff, and were issued without adequate due diligence.[24] *See* TC ¶¶

[24] William Fry's active participation in the drafting of the solicitation documents constitutes "affirmative action," and thus a fiduciary duty is not required. *See* TC ¶ 225-27. Disputing the truth of the Thema Plaintiffs' well-pled allegations, William Fry mischaracterizes its conduct as

5-13, 48, 62-64, 225-30, 518-21. Moreover, the Complaints allege that William Fry had actual knowledge of numerous breaches of fiduciary duty committed by Defendants, including the concealment of Madoff as a sole investment advisor, the minimal due diligence conducted, Madoff's deficient qualifications, and the numerous conflicts of interest ignored. *Id.* These allegations and surrounding circumstances certainly suffice to raise at least "some rational basis" for inferring actual knowledge and substantial assistance, which is all that is required at this stage. *Houbigant, Inc. v. Deloitte & Touche LLP*, 753 N.Y.S.2d 493, 498 (N.Y. App. Div. 2003); *see also Oster v. Kirschner*, 905 N.Y.S.2d 69, 72 (N.Y. App. Div. 2010) (finding investor had pled an adequate inference of actual knowledge against law firm where it had drafted documents that "were the means by which [investment entities] were able to solicit funds for … a Ponzi scheme"); *Anwar II*, 728 F. Supp. 2d at 443; *Facciola v. Greenburg Traurig LLP*, No. CV-10-1025-PHX-FJM, 2011 WL 2268950, at *9 (D. Ariz. June 9, 2011) (law firm liable as aider and abettor for "preparing multiple [offering documents] for the soliciting of investors" for a fraudulent investment scheme).

3. Plaintiffs' Fraud and Aiding and Abetting Fraud Claims are Sufficient to Survive a Motion to Dismiss

There is absolutely no question that Madoff and BLMIS committed fraud. Indeed, as a result of his substantial criminally fraudulent activities, Madoff was sentenced to 150 years in prison. *See* HC ¶ 6; PC ¶ 1; TC ¶ 5. The Primeo Plaintiffs allege that PGAM, the Primeo Funds, the Primeo Director Defendants, the Primeo E&Y Defendants, the Primeo Administrator and the

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"failing to stop … disseminat[ion] by Thema." *See* Dugan Decl. at 4 (mistakenly characterizing such conduct as "failing to stop … disseminat[ion] by Thema"). The Court should reject William Fry's mischaracterization. Nonetheless, Thema Plaintiffs have alleged William Fry's duty to the investors who relied on the errant documents it prepared. *See* TC ¶¶ 225-30. And even so, whether a fiduciary duty exists "depends on the facts of a particular relationship, [and] therefore a claim alleging the existence of a fiduciary duty usually is not subject to dismissal." *Abercrombie*, 438 F. Supp. 2d at 274; *Musalli Factory*, 261 F.R.D. at 26 ("New York courts generally avoid dismissing a claim of breach of fiduciary duty [at the motion to dismiss stage] because it usually involves a question of fact.").

Primeo Custodians (collectively, the " Fraud Defendants") each engaged in fraud. *See* PC C 19, 21, 23, 25. Additionally, the Herald Plaintiffs allege that each of the Defendants named in the Herald Complaint aided and abetted the fraud committed by Madoff and BLMIS, non-parties as a result of their bankruptcy filings. *See* HC C 19.

To successfully plead fraud, the Primeo Plaintiffs must allege "a misrepresentation or failure to disclose a material fact, falsity, scienter, justifiable reliance by plaintiff and damages." *Kaufman v. Cohen*, 760 N.Y.S.2d 157, 166 (N.Y. App. Div. 2003). In so doing, the Primeo Plaintiffs must satisfy the pleading requirements of Fed. R. Civ. P. 9(b). *Muller-Paisner v. TIAA*, 289 Fed. Appx. 461, 463 (2d Cir. 2008). However, the pleading requirements of Rule 9(b) are relaxed when, as here "information is exclusively within the defendant's knowledge." *DGM Invs., Inc. v. N.Y. Futures Exch., Inc.*, 265 F. Supp. 2d 254, 264 (S.D.N.Y. 2003) (noting that "[d]ismissal on the ground that facts within [d]efendants' knowledge have not yet been proven in the pleading stage is 'particularly inappropriate'" (citation omitted)).

The Primeo Plaintiffs allege that the Fraud Defendants specifically named in their Complaint recklessly and/or knowingly made various deceptive and untrue statements of material facts and omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading to Plaintiffs and the class, in order to induce Plaintiffs and the class to invest in the Primeo Funds. PC ¶¶ 338, 374, 388. Moreover, the Primeo Plaintiffs specifically detail, *inter alia*, how the Fraud Defendants provided fraudulent, unverified Primeo transaction slips and/or account statements and/or issued financial statements which they claimed to audit, but did not. *See*, *e.g.*, PC ¶¶ 340-53, 375-83, 388.

The elements of a claim for aiding and abetting fraud are similar to the elements of a claim for 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)). However, an aiding and abetting fraud claim is subject to the pleading requirements of Fed. R. Civ. P. 9(b). *Id.* 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. v. Beacon Hill Asset Mgmt., LLC*, 479 F. Supp. 2d 349, 368 (S.D.N.Y. 2007). 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 Herald Plaintiffs allege, with particularity, that the Herald Defendants, in light of substantial and ongoing red flags (*e.g.*, HC ¶¶ 3, 5, 54, 430-85, 488-510, 551-67, 576, 578, 582, 585-86, 606-13, 615-16, 622-27) knew or consciously disregarded Madoff and/or BLMIS' fraud, but still lent substantial assistance to Madoff and/or BLMIS which perpetuated the fraud. HC ¶ 797, 799-800.[25] The Herald Defendants' actions, as detailed in the Herald Complaint, caused the Herald Plaintiffs and the class substantial damage. HC ¶¶ 804-05. These allegations are pled with particularity and sufficient to defeat Defendants' motion to dismiss.

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[25] The Herald Plaintiffs have also sufficiently alleged civil conspiracy. *See* HC C 1. Contrary to Defendants' assertions (Def. Br. at 39), Plaintiffs have "connected" their "claim for civil conspiracy" to their sufficiently pled "separate underlying tort". *See Meisel v. Grunberg*, 651 F. Supp. 2d 998, 119 (S.D.N.Y. 2009) (cited by Defendants). *Inter alia*, the Herald Plaintiffs allege, *inter alia* "Defendants shared a knowing and malicious intent to injure Plaintiffs and the other members of the Class and to wrongfully deprive and defraud the property of Plaintiffs and the other members of the Class." HC ¶ 648. These allegations connect the Herald Plaintiffs' conspiracy claim to their sufficiently pled aiding and abetting fraud claim. *See also* HC ¶ 649.

4. Plaintiffs Have Alleged Valid Claims for Imposition of Constructive Trust

The elements of a constructive trust are: (1) a fiduciary relationship, (2) a promise, (3) a transfer in reliance thereon, and (4) unjust enrichment. *Plumitallo v. Hudson Atl. Land Co., LLC*, 903 N.Y.S.2d 127, 129 (N.Y. App. Div. 2010). Here, each of the Plaintiffs alleges a fiduciary relationship, a promise by Defendants to conduct adequate due diligence and supervision of Madoff, an investment in the Funds in reliance on these promises, and Defendants' unjust enrichment based on Madoff's fictitious profits. Accordingly, Plaintiffs sufficiently allege the elements for a constructive trust. *See* HC C 8; PC C 5; TC C 18.

5. Plaintiffs Have Alleged Valid Claims for Unjust Enrichment

To state a claim for unjust enrichment under New York law, "a plaintiff must allege that (1) defendant was enriched; (2) the enrichment was at plaintiff's expense; and (3) the circumstances were such that equity and good conscience require defendants to make restitution." *Intellectual Capital Partner v. Inst. Credit Partners LLC*, No. 08 Civ. 10580 (DC), 2009 WL 1974392, at *8 (S.D.N.Y. July 8, 2009) (citation omitted). A direct relationship is not required to assert unjust enrichment. *See In re Canon Cameras Litig.*, No. 05 Civ. 7233(JSR), 2006 WL 1751245, at *2 (S.D.N.Y. June 23, 2006).

Here, Plaintiffs allege that Defendants wrongly garnered substantial monies based on the Funds' fictitious profits at the expense of Plaintiffs and other members of the proposed classes. *See*, *e.g.*, HC ¶¶ 2, 66, 197-207, 222, 240-41, 328-29; PC ¶¶ 3, 6, 8, 20, 73, 76, 81, 84, 88, 95, 109, 149, 154; TC ¶¶ 11, 16, 19, 50, 52, 154, 156, 302-05, 320. Defendants collected these funds in the form of commissions, performance fees, service fees, and/or investment profits, despite the fact that Madoff's investment business, and hence the Funds' investments, were nonexistent and wholly fabricated. In light of these facts, Plaintiffs most certainly did not receive "what they paid for." This suffices to plead unjust enrichment. *Anwar II,* 725 F. Supp. 2d at 421 (sustaining

unjust enrichment claims); *see also Intellectual Capital Partner*, 2009 WL 1974392, at *8-9; *Space*, *Inc. v. Simowitz*, No. 08 Civ. 2854 (SAS), 2008 WL 2676359, at *3 (S.D.N.Y. July 8, 2008); *Cruz v. McAneney*, 816 N.Y.S.2d 486, 490-91 (N.Y. App. Div. 2006).

Further, as amply alleged, *see* TC ¶¶ 141, 312-57, it would be "against equity and good conscience to permit [JPM] to retain" the hundreds of millions of dollars it received at Plaintiffs' expense by furthering and ignoring Madoff's scheme. *Paramount Film Distrib. Corp. v. New York*, 285 N.E.2d 695, 698 (N.Y. 1972); *Waldman v. New Chapter, Inc.*, 714 F. Supp. 2d 398, 404 (S.D.N.Y. 2010) ("Under New York law, it is contrary to equity and good conscience to enable a party to benefit from misleading representations." (citation omitted)). And contrary to JPM's cursory challenge, *see* Hynes Decl. at 5, under New York law, "[i]t does not matter whether the benefit is directly or indirectly conveyed." *Mfrs. Hanover Trust Co. v. Chemical Bank*, 559 N.Y.S.2d 704, 708 (N.Y. App. Div. 1990). Moreover, despite any purported contract between JPM and any third party, "unjust enrichment may be pleaded alternatively." *Auguston v. Spry*, 723 N.Y.S.2d 103, 106 (N.Y. App. Div. 2001); *Bildstein v. MasterCard Int'l, Inc.*, No. 03 Civ. 9826I (WHP), 2005 WL 1324972, at *5 (S.D.N.Y. June 6, 2005) (holding that a contract between a party and a third party does not preclude recovery for unjust enrichment). Since "[P]laintiff[s] maintain[] that [JPM] retained proceeds to which it was not entitled, a triable issue … exists as to whether it was unjustly enriched" and thus dismissal should be denied. *Ultramar Energy Ltd. v. Chase Manhattan Bank, N.A.*, 579 N.Y.S.2d 353, 354 (N.Y. App. Div. 1992).[26] The Thema Plaintiffs' claims of unjust enrichment against BNY Mellon and William Fry survive dismissal for much the same reasons. *See* TC ¶¶ 5-13, 48, 62-64, 141, 225-30 (alleging William

[26] JPM's invocation of *in pari delicto* is premature. Under New York law, *in pari delicto* is an affirmative defense placing the burdens of pleading and proof on the defendant, and goes to the merits of the derivative claims. *See*, *e.g.*, *Woods v. Rondout Val. Cent. School Dist. Bd. of Educ.*, 466 F.3d 232, 237 (2d Cir. 2006). Moreover, here it would require complex, fact-specific determinations of agency and culpability. *Id.* Such an in-depth determination, without the benefit of any discovery, would be inappropriate at the pleading stage.

Fry unjustly received fees for purported services that were largely, if not entirely, unperformed); TC ¶¶ 225-30 (same for BNY Mellon).

6. The Herald Plaintiffs Have Alleged a Valid Claim for Conversion

"To sustain an action for conversion of an identifiable sum of money, plaintiff must allege that he had ownership, possession or control of the money which is the subject of the action. Plaintiffs must show that they had 'an immediate superior right of possession to the identifiable fund and the exercise by defendants of unauthorized dominion over the money in question to the exclusion of plaintiff's rights.'" *Fiorenti v. Cent. Emergency Physicians*, 723 N.Y.S.2d 851, 856 (N.Y. Sup. Ct. 2001) (citing *Bankers Trust Co. v. Cerrato*, *Sweeney*, *Cohn*, *Stahl & Vaccaro*, 187 A.D.2d 384, 385 (1st Dep't 1992)).

The Herald Plaintiffs assert their claim for conversion against HAML, the Herald Funds and the Herald HSBC Defendants. They allege the monies they and the class invested with Defendants were never invested pursuant to the parties' agreements. HC C 2. The amounts Plaintiffs invested, moreover, should be easily identifiable as those funds were not intermingled at the time Plaintiffs invested them. Plaintiffs are entitled to pursue claims to recover monies wrongly paid to Defendants based on Madoff's fictitious profits and rightfully theirs.

7. Plaintiffs Have Properly Pled Claims for Breach of Contract and/or a Third Party Beneficiary Claim for Breach of Contract

a. Breach of Contract

The Herald and Primeo Plaintiffs have sufficiently pled direct causes of action for breach of contract, *see* HC C 6, PC C 9, and the Thema Plaintiffs have sufficiently pled a derivative cause of action for breach of contract. TC C 17.

Contrary to Defendants' assertions, *see* Def. Br. at 36, the Herald and Primeo Plaintiffs have identified the contractual obligations which Defendants disregarded. In fact, both the Herald and Primeo Plaintiffs specifically allege that Plaintiffs signed Subscription Agreements,

expecting their monies to be legitimately invested in the Herald and Primeo Funds. HC C 6; PC C 9. Further, the Thema Plaintiffs allege that Defendants breached contractual duties owed to the Fund itself; indeed, the Thema Plaintiffs Complaint is replete with agreements made between Defendants and the Thema Fund (*see* TC ¶ 528), and what the parties' duties were under those contracts. *See*, *e.g.*, TC ¶¶ 102, 143, 148-51, 157-58, 161-66, 209-14. These three claims easily satisfy the pleading requirements of Fed. R. Civ. P. 8(a).

b. Third Party Beneficiary Claim for Breach of Contract

The Primeo and Thema Plaintiffs' claims for third-party breach of contract are also governed by the liberal notice pleading standards of Rule 8(a). *Caudle v. Towers*, *Perrin*, *Forster & Crosby*, *Inc.*, 580 F. Supp. 2d 273, 284 (S.D.N.Y. 2008). Accordingly, the Complaints need only allege facts "sufficient 'to raise a right to relief above the speculative level.'" *ATSI Commc'ns*, 493 F.3d at 98 (quoting *Twombly*, 550 U.S. at 555).

Even without the benefit of discovery, Plaintiffs plead facts that support claims that they were intended third-party beneficiaries. *See* PC C 7; TC C 16. However, the determination of "third-party beneficiary status is a question of fact." *Debary v. Harrah's Operating Co.*, 465 F. Supp. 2d 250, 261 (S.D.N.Y. 2006). Where there is any ambiguity in contractual language, courts – even at summary judgment – typically refuse to decide the issue of whether the contract intended to confer third-party beneficiary status. *See*, *e.g.*, *Barry v. Atkinson*, No. 96 Civ. 8436(PKL), 1998 WL 255431, at *3 (S.D.N.Y. May 20, 1998).

New York has adopted the Restatement (Second) of Contracts § 302 (1981), which sets forth the elements of a third-party breach of contract claim. *Fourth Ocean Putnam Corp. v. Interstate Wrecking Co. Inc.*, 485 N.E.2d 208, 211-12 (N.Y. 1985). Under the Restatement, a party will be deemed an intended beneficiary with rights to enforce a contract if "recognition of the beneficiary's right to performance must be appropriate to effect the intention of the parties"

and "the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance." *Id.* at 212 & n.2. 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) ("In determining third party beneficiary status it is permissible for the court to look at the *surrounding circumstances* as well as the agreement ... it is well-settled that the obligation to perform to the third party beneficiary need not be expressly stated in the contract.") (emphasis added).

As alleged in the Primeo and Thema Complaints, the Primeo Funds entered into a contractual relationship with the Primeo Advisor Defendants and the Thema Fund entered into contractual relationships with HTIE, HSSI, the Thema Medici Defendants, and the Thema Advisor Defendants. PC ¶¶ 253-54; TC ¶¶ 522-23. Under the Primeo and Thema Advisory Agreements, the relevant Defendants assumed responsibility to fulfill certain contractual obligations with respect to the Funds for the intended benefit of the Primeo and Thema Plaintiffs and the classes. However, as alleged in the Complaints, these Defendants failed to, *inter alia*, ensure adherence to the Funds' investment policies and objectives; perform due diligence; open and maintain accounts with brokers according to the regulations of each market in which the securities were traded; monitor the Funds' investments; conduct meaningful due diligence of Madoff; meaningfully monitor and oversee Madoff; confirm the existence of assets; and perform the job duties they claimed to be performing. PC C 7; TC C 16. As alleged in the Complaints, these contractual breaches resulted in significant losses to Plaintiffs and the proposed Primeo and Thema classes. *Id.* At this early stage of litigation, Plaintiffs' allegations are sufficient to survive dismissal.

Plaintiffs allege Defendants charged with negligence breached their duties by, *inter alia*, failing to monitor Madoff and/or BLMIS, perform any procedures to gain an understanding of

Madoff's and/or BLMIS' business and business practices; and/or monitor the Funds' assets, including failing to take reasonable and/or adequate steps to: (i) confirm Madoff's purported account statements, transactions, and holdings of the Funds' assets; (ii) ensure that investments of Plaintiffs' assets were made and maintained in a prudent and professional manner; and (iii) preserve the value of Plaintiffs' investments. Additionally, the Auditor Defendants failed to properly audit the Funds in accordance with GAAS, ISA or even their own auditing and accounting standards. *See*, *e.g.*, HC C 6, 11, 12, 15; PC C 3, 9, 11, 14-17; TC C 1-4, 7-8.

C. Plaintiffs' Allegations Against the Auditors Are Sufficient

1. Plaintiffs Have Adequately Stated Claims Against E&Y

EYG, EY Cayman, and EY Lux (collectively "E&Y")[27] argue Plaintiffs' claims against them should be dismissed because (1) Plaintiffs' common law fraud allegations do no more than recite accounting standards that E&Y violated and red flags that E&Y missed; (2) there was insufficient privity between E&Y and Plaintiffs to sustain claims for gross negligence, negligence, and negligent misrepresentation; (3) Plaintiffs' aiding and abetting claims are not supported by facts demonstrating that E&Y knowingly assisted the other Defendants; and (4) Plaintiffs' common law claims relating to audit reports issued before March 2006 are time-barred by New York's three-year statute of limitations for professional conduct. Weinstein Decl. ¶¶ 4-11. Each of these arguments fails. E&Y did not merely miss red flags or violate accounting standards – it systematically ignored evidence of fraud that well-established accounting standards and its own audit procedures were designed to detect. There was sufficient privity between E&Y and the shareholders of the Primeo and Herald Funds, moreover, to support claims for gross negligence, negligence, and negligent misrepresentation under New York law.

[27] The Primeo Complaint alleges claims against EY Cayman and EYG. PC ¶¶ 96-146. The Herald Complaint alleges claims against EY Lux, EY Cayman and EYG. HC ¶¶ 511-567. The Complaints detail how Ernst & Young is a unitary global entity which collectively refers to itself as "E&Y." PC ¶¶ 96-103; HC ¶¶ 514-20; *see also infra* at Section IV.D.

Likewise, Plaintiffs sufficiently allege E&Y's actual knowledge of fraud and assistance to other Defendants to support claims of aiding and abetting fraud, conversion, and breach of fiduciary duty. Finally, none of Plaintiffs' claims are time-barred because the relevant statute of limitations was tolled by E&Y's continuous representations to shareholders as the Funds' auditors.

a. Plaintiffs Adequately Allege That Ernst & Young Committed Fraud By Ignoring Red Flags and Violating Accounting Standards

E&Y argues that Plaintiffs merely list various red flags that it missed and accounting standards that it violated and that such allegations are insufficient to sustain claims for common law fraud. Weinstein Decl. ¶¶ 8-9. E&Y's argument fails because, on the contrary, Plaintiffs adequately allege that in violation of well-known accounting standards and its own audit procedures, E&Y knowingly or recklessly misrepresented the accuracy of the Funds' financial statements by missing consistent evidence that the assets underlying BLMIS were fictional – misrepresentations upon which Plaintiffs relied.

A plaintiff adequately pleads common law fraud under New York law by alleging that an auditor knowingly or recklessly made material misrepresentations or omissions, upon which the plaintiff relied, and which reliance caused the plaintiff's injuries. *Meridian Horizon Fund*, *LP v. Tremont Group Holdings*, *Inc.*, 747 F. Supp. 2d 406, 413-14 (S.D.N.Y. 2010) (listing elements of common law fraud in New York); *see also In re Scottish Re Group Sec. Litig.*, 524 F. Supp. 2d 370, 385 (S.D.N.Y. 2007) (allegations of recklessness sufficient to support allegations of common law fraud). Here, E&Y misrepresented the existence of BLMIS' assets when it certified that the Primeo Funds' and Herald Funds' financial statements were accurate; it knew or recklessly disregarded that its certification was false because it had not verified the existence of those assets; and Plaintiffs relied upon E&Y's misrepresentations to their detriment. *See* PC ¶¶

107-135, HC ¶¶ 525-550.

Defendants characterize Plaintiffs' arguments as merely enumerating "red flags" that E&Y failed to notice. Weinstein Decl. ¶ 9. Quite the contrary, Plaintiffs have alleged facts demonstrating that E&Y systematically failed to adequately audit the Funds, but nonetheless recklessly certified the accuracy of the Funds' financial statements to investors. E&Y cannot characterize its consistent violations of accounting standards and its ignorance of red flags as a mere failure to investigate. E&Y's failure to conduct a meaningful audit is evidenced by its violation of generally accepted accounting standards and by its failure to adhere to its own audit procedures. Indeed, E&Y failed to perform the most basic function an auditor has, namely, to confirm that the assets at issue actually existed.

In its audits of the Primeo and Herald Funds, E&Y was governed by generally accepted accounting standards which required that it "plan and perform the audit[s] to obtain *reasonable assurance* about whether the [Funds'] financial statements are free of material misstatements, *whether caused by error or fraud*." HC ¶ 536; PC ¶ 115 (citing Accounting Standards Board (AU) § 110.02) (emphasis added). E&Y was further required to "obtain a sufficient understanding of the [Funds] and [their] environment, including [the Funds'] internal controls" when ensuring their financial statements were free of misstatements. HC ¶¶ 534, 537; PC ¶ 116. Accounting standards dictate that professional skepticism should be exercised throughout audits. HC ¶¶ 538-39; PC ¶ 118. Additionally, auditors should apply increased scrutiny to entities with securities investments <u>to verify that the securities exist</u>. HC ¶¶ 552-53; PC ¶¶ 119-20. E&Y should have verified transactions through physical inspection, confirmation with the holder or issuer of the securities, or confirmation with broker-dealers or counterparties. HC ¶ 541; PC ¶ 120. E&Y is no stranger to these standards. E&Y's marketing material advertised its ability to "investigate unusual financial activity" and touted its "experience dealing with matters of

accounting malpractice and anticorruption." HC ¶¶ 561-66; PC ¶¶ 140-46. Notably, E&Y also promised to perform "thorough buy-side and sell-side due diligence." *Id.*

Despite E&Y's obligation to adhere to these accounting standards and despite its supposed extensive due diligence and expertise in reviewing unusual transactions, E&Y failed to conduct meaningful audits that would have uncovered the fact that BLMIS' assets were nonexistent and its transactions were fraudulent. E&Y was required to review the controls BLMIS had in place because BLMIS was its own servicer and custodian, but E&Y failed to do so. HC ¶ 545; PC ¶ 124. Further, because BLMIS initiated its own trades, held its securities, and prepared its own account information, E&Y should have conducted additional inquiries. HC ¶ 546; PC ¶ 125.[28] Significantly, E&Y failed to notice any of the extensive indications that BLMIS' investments were fraudulent: Madoff's non-existent counterparties; Madoff's custody of equity securities; Madoff's claim that the assets of BLMIS were entirely invested in government securities at the end of each year; Madoff's unbalanced hedges, which were inconsistent with his split-strike conversion strategy; Madoff's unknown and small auditing firm; Madoff's secretive operation; Madoff's paper trading records; Madoff's consistent returns; Madoff's impossible trades, which occasionally occurred on Saturdays or other days the markets were closed; Madoff's impossible trade volumes, which were occasionally in excess of total market volume on a given day; and Madoff's generous fee structure. HC ¶¶ 488-90, 494, 511-13, 558-60; PC ¶¶ 168-88.

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[28] E&Y contends that it had no independent responsibility to audit BLMIS because F&H was responsible for auditing BLMIS. However, as the auditor of the Herald and Primeo Funds, E&Y had a duty to examine F&H's audits and apply additional auditing procedures if the F&H audits were unsatisfactory. The F&H audits were presumptively unsatisfactory because F&H did not hold itself out as a member of the American Institute of Certified Public Accountants and was therefore not subject to peer review. Despite this information, E&Y failed to meaningfully assess F&H's audits. HC ¶ 556; PC ¶ 135.

Nonetheless, E&Y recklessly represented that the valuations of the Funds' investments were fairly presented without performing any of the audit procedures it was obligated to. E&Y failed to confirm Madoff's transactions with even one counterparty. HC ¶ 541; PC ¶ 120. E&Y did not test the split-strike conversion strategy despite its reliance on heavy options trading. HC ¶ 559; PC ¶ 138. E&Y did not apply further scrutiny despite BLMIS' consistent positive returns and annual liquidations. *Id.* Indeed, E&Y failed even to test the trades made by BLMIS or confirm the actual existence of the securities in BLMIS accounts – its most basic function. *Id.* E&Y could not have failed to notice the ongoing fraud within BLMIS without also recklessly ignoring warning signs and relevant accounting standards. The purported risky strategies within BLMIS, its consistent returns, its unusual reporting practices, and dozens of other practices were more than red flags; they were bright indications that should have led E&Y to perform adequate accounting and verification procedures. *See Varghese v. China Shenghuo Pharm. Holdings*, *Inc.*, 672 F. Supp. 2d 596, 610 (S.D.N.Y. 2009) (inferring recklessness upon allegations that the auditor disregarded red flags and committed GAAS and GAAP violations); *In re Winstar Commc'ns*, Nos. 01 CV 3014(GBD), 01 CIV 11522, 2006 WL 473885, at *11 (S.D.N.Y. Feb. 27, 2006) (concluding that allegations of reckless disregard of red flags and accounting standard violations were sufficient to infer scienter).

b. Ernst & Young "Sufficiently Approach[ed] Privity" With Plaintiffs

Notwithstanding their failure to detect bright red flags, E&Y claims it should be excused from its negligence because it lacks privity with Plaintiffs. In particular, E&Y contends that there was no "near privity" between it and the Funds' shareholders because it did not issue any audit report directly to a shareholder or even know of the existence of a particular shareholder. Weinstein Decl. ¶ 4. E&Y argues that this lack of privity compels dismissal of Plaintiffs' claims of gross negligence, negligence, and negligent misrepresentation. *Id.* E&Y further argues that

courts require direct contact between auditors and shareholders to support privity. *Id.*

E&Y's arguments are not well reasoned. Judge Marrero faced nearly identical facts and arguments in *AnwarII* and rejected the auditor's argument that it lacked privity with the plaintiffs. *See Anwar II*, 728 F. Supp. 2d at 457 (holding that plaintiffs had alleged sufficient privity between shareholders and auditors under the test in *Credit Alliance Corp. v. Arthur Andersen & Co.*, 483 N.E. 2d 110, 119 (N.Y. 1985)). In *Anwar II*, Judge Marrero applied the three-element test in *Credit Alliance* and concluded that privity existed between the auditor and the shareholders in a Madoff feeder fund case similar to this case. *See Anwar II*, 728 F. Supp. 2d at 450-57.

In *Credit Alliance*, the court held that an auditor's liability is not limited to those who contract with it, but rather extends to those who have a relationship with the auditor "sufficiently approaching privity." *Credit Alliance*, 483 N.E.2d at 119. This near-privity requirement is met when (1) the auditor was aware that audited financial reports would be used for particular purposes; (2) the auditor intended for a known party to rely on the financial reports; and (3) "there must have been some conduct on the part of the [auditors] linking them to the party or parties, which evinces the [auditors'] understanding of that party or parties' reliance." *Id.* at 118.

In *Anwar II*, Judge Marrero held that the auditor was in privity with shareholders because it was aware "that the financial reports [the auditor] produced for the Funds were to be used for the particular purpose of evaluating investments in the funds." *Anwar II*, 728 F. Supp. 2d at 455. Judge Marrero was not persuaded by the auditor's contention that audit reports were not issued to a particular plaintiff, holding instead that allegations that plaintiffs would rely on reports in making their investment decisions could support an inference that the auditor knew its reports would be relied upon. *Id.* Finally, Judge Marrero rejected the argument that the *Credit Alliance* conduct element required face-to-face contact and concluded that allegations that the reports

were addressed to shareholders were sufficient. *Id.* at 456; *see also Dorking Genetics v. United States*, 76 F.3d 1261, 1270 (2d Cir. 1996) (broadly construing the conduct requirement of the *Credit Alliance* test).

The facts here are nearly identical to the facts in *AnwarII* and indicate that E&Y was in sufficient privity with Plaintiffs. E&Y was aware that the audit reports it issued for the Primeo Funds between 2003 and 2007 and for the Herald Funds from 2004 to 2007 would be used and relied upon by investors because each new investor signed an Offering Memorandum and a Subscription Agreement *listing Ernst & Young as the Funds' auditor.* PC ¶ 104; HC ¶ 521. E&Y's issuance of audit reports with the knowledge that investors signed documents listing E&Y as the Funds' auditor evidences E&Y's understanding of investors' reliance. *Id.*; *see Anwar II*, 728 F. Supp. 2d at 456 (citing as evidence that plaintiffs relied upon audit reports allegations that the auditor knew it was listed as the fund's auditor in marketing material and allegations that the auditor knew its audit letters were provided to potential investors). E&Y's argument that it wrote audit reports for a hedge fund without knowing that the investors of the hedge fund would rely on the audit report – which was supposed to verify the very existence of the underlying assets – strains credulity. No other party relied on E&Y's audit reports to a greater extent than investors.

c. The Ernst & Young Defendants Knew of or Substantially Assisted in Fraud, Breach of Fiduciary Duty, and Conversion

E&Y asserts that the Complaints fail to adequately allege aiding and abetting claims because they contain no facts evidencing its knowledge of fraud or its substantial assistance to other Defendants. Weinstein Decl. ¶ 10.[29] E&Y does not challenge other elements of Plaintiffs'

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[29] E&Y also maintains that EYG and EY Lux are sufficiently separate from EY Cayman such that EYG and EY Lux are not responsible for the contents of reports issued by EY Cayman. The unitary nature of E&Y is detailed at length in both the Herald and Primeo Complaints, and

aiding and abetting claims. *Id.* E&Y's argument fails because each Complaint includes sufficient evidence that E&Y knew of and substantially assisted in the fraud, breaches of fiduciary duty, and conversion alleged therein. *See Pension Comm.*, 2007 WL 528703, at *7 (denying a motion to dismiss aiding and abetting claims because red flags supported an inference of knowledge of the underlying breach of fiduciary duty and fraud).

Plaintiffs have sufficiently pled actual knowledge on the part of E&Y. Actual knowledge can be inferred from circumstantial evidence. *Id.* Additionally, willful blindness or conscious avoidance, sufficiently pled, satisfy the actual knowledge requirement. *See OSRecovery*, 354 F. Supp. 2d at 378; *Cromer*, 2003 WL 21436164, at *9 (denying summary judgment to an auditor when plaintiffs provided evidence sufficient for a jury to infer that the auditor consciously avoided the underlying fraud).

Here, the facts alleged show that E&Y was at least willfully blind. E&Y accepted the audit reports of F&H, a non-AIPAC member, without careful scrutiny. HC ¶ 559; PC ¶ 138. E&Y did not test the performance, strategy, or assets of the Madoff-managed Funds. *Id.* E&Y also did not verify the trades made within the Funds. *Id.* A global accounting firm with the experience and prestige of Ernst & Young surely knows to be suspicious of consistent positive returns, especially from Funds without transparency and without a qualified auditor. Indeed, as noted above, E&Y ignored a series of blatant indications of Madoff's fraudulent activities. HC ¶¶ 488-90, 494, 511-13, 558-60; PC ¶¶ 168-88. Despite these warning signs, E&Y took no steps to investigate. E&Y's unwillingness to question the financial results of BLMIS evidences what was at least conscious avoidance of obvious wrongdoing. A jury could easily infer that E&Y's unwillingness showed knowledge of the investment firm's practices. *See Cromer*, 2003 WL 21436164, at *1, 9 (evidence that the auditor had failed to detect false monthly account

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E&Y cannot claim a lack of knowledge or assistance based on the frail separation of EYG from its sub-parts. *See infra* at Section IV.D.

statements suffices to show knowledge of underlying violations).

Plaintiffs have also sufficiently pled that E&Y assisted the fraud, conversion, and breaches of fiduciary duty of the other Defendants. An auditor substantially assists an underlying wrong when the auditor "affirmatively assists, helps conceal, or fails to act when required to do so, thereby enabling the breach to occur." *Lerner*, 459 F.3d at 295 (upholding aiding and abetting claims against bank defendant). As already outlined above, investors in the Primeo and Herald Funds relied on the statements in E&Y's audit reports in making their investment decisions. E&Y certified that it conducted audits of the Herald and Primeo Funds, that those audits conformed to generally accepted accounting standards, and that the Funds' financial statements accurately reflected the Funds' financial condition. HC ¶¶ 511, 521; PC ¶ 104. E&Y does not dispute that it certified the accuracy of the Funds' financial statements and cites no authority to support its claim that its audit opinions were "ordinary business functions" and therefore incapable of assisting Defendants' fraud, breaches of fiduciary duty, and conversion. *See* Weinstein Decl. ¶ 10. Indeed, E&Y's certification of the Funds' financial statements represented to investors that the assets in the Funds actually existed – a certification without which the Funds would have been unmarketable.

d. Plaintiffs' Claims Are Timely

E&Y asserts that Plaintiffs' claims based on audit reports it issued before March 2006 are time-barred under New York's three-year statute of limitations for professional conduct. Weinstein Decl. ¶ 11 (citing N.Y. C.P.L.R. §§ 214(4)-(6) (2009)). E&Y's argument fails because all of its audit reports were part of a single, continuous representation. *See Symbol Techs., Inc. v. Deloitte & Touche, LLP*, 888 N.Y.S.2d 538, 541 (N.Y. App. Div. 2009) (tolling statute of limitations for claims against auditor when plaintiff alleged that parties mutually contemplated ongoing professional relationship). Continuous representation, evidenced by a

professional relationship that is understood to be ongoing, tolls the statute of limitations as long as the relationship continues. *Id.*

The relationship between E&Y and the Funds here was one of continuous representation, and Plaintiffs' claims are therefore timely. E&Y issued audit reports for the Primeo Funds from 2003 to 2007 and for the Herald Funds from at least 2004 to 2007. PC ¶ 104; HC ¶ 521. Both Funds listed E&Y as their auditor in the Offering Memoranda and Subscription Agreements signed by investors. *Id.* These facts evidence a continuous representation by E&Y as the Funds' auditor. Because E&Y was the Funds' auditor for an ongoing period the statute of limitations was tolled, and Plaintiffs' claims based on all of the audit reports are timely. *See id.* (allowing exception to statute of limitations upon allegations that the audit relationship continued for many years pursuant to separate engagement letters that did not mandate a conclusion to the relationship); *Buchwald v. The Renco Group*, 399 B.R. 722, 753-54 & n.96 (Bankr. S.D.N.Y. 2009) (dismissal inappropriate when allegations in complaint raised inference that continuous representation doctrine applied).

2. Plaintiffs Have Adequately Stated Claims Against PwC

Likewise, the Thema Plaintiffs have adequately pled claims against PwC. Because of, *inter alia*, its "superior position [and] access to confidential information," which led investors to "repose trust and confidence," PwC owed a duty of care to the class. *See White v. Guarente*, 372 N.E.2d 315, 318-19 (N.Y. 1977) (accountants owe a duty of care for services relied upon by plaintiffs who are part of an identifiable group); *see also Pension Comm.*, 446 F. Supp. 2d at 195-96; *Anwar II*, 728 F. Supp. 2d at 447; *Credit Alliance*, 483 N.E.2d at 120. Notwithstanding this duty, PwC failed to properly audit Thema in accord with applicable standards and protocols, failed to conduct necessary procedures to gain an understanding of Madoff or BLMIS, failed to independently verify information from Madoff despite notice of circumstances raising doubts as

to the veracity of the provided information, and remained willfully blind to myriad red flags surrounding Madoff and his massive fraud. *See, e.g.*, TC ¶¶ 231-301, 417-62. Nevertheless, PwC issued clean, unqualified audit opinions while knowing full well that the class would, as could be reasonably expected, rely thereon to its detriment. *Id.* These allegations more than suffice to plead negligence, and indeed reflect gross negligence. *See Anwar II*, 728 F. Supp. 2d at 454-57 (finding negligence pled against auditor of Madoff feeder fund); *Houbigant, Inc.*, 753 N.Y.S.2d at 499 ("An auditor's failure to independently verify financial statements may give rise to [such] a claim … especially where the auditor 'had notice of particular circumstances raising doubts as to the veracity of such information.'") (quoting *Foothill Capital Corp. v. Grant Thornton, LLP*, 715 N.Y.S.2d 389, 390 (N.Y. Sup. Ct. 2000)).

PwC's conclusory assertions otherwise are entirely unavailing. *See* Ryan Decl. at 3. Pleading negligence "does not require an auditor know a 'particular' third party by name." *Anwar II,* 728 F. Supp. 2d at 456. Rather, "an accountant owes a duty to '[members] of a settled and particularized class among the 'members of which [its] report would be circulated.'" *Id.* (quoting *White*, 372 N.E.2d at 320). And "audit reports, addressed to the shareholders, constitute substantial communication between [the auditor] and the plaintiff-shareholders sufficient to satisfy the 'linking conduct' requirement." *Cromer Fin. Ltd. v. Berger*, No. 00 Civ. 2498, 2001 WL 1112548, at *5 (S.D.N.Y. Sept. 19, 2001) (internal citations omitted). Such allegations also suffice to plead reasonable reliance, *see Anwar II*, 728 F. Supp. 2d at 448-49, and in any event reliance "is intensely fact-specific and generally considered inappropriate for determination on a motion to dismiss." *Maloul v. Berkowitz*, No. 07 Civ. 8525(LBS), 2008 WL 2876532, at *2 (S.D.N.Y. July 23, 2008).

So too, PwC fails to counter the well-pled aiding and abetting claims it faces. *See* Ryan Decl. at 4-5. Particularity is not required of these claims. *Anwar II*, 728 F. Supp. 2d at 443

("actual knowledge need only be pleaded generally" (citation omitted)). As such, "plaintiffs' allegations that defendants had the authority to track fund performance, which allowed them to know that the net asset value of the fund was overstated, sufficiently plead actual knowledge of the fraud as discerned from the surrounding circumstances." *Balance Return Fund Ltd.*, 921 N.Y.S.2d at 40; *see also Houbigant, Inc.*, 753 N.Y.S.2d at 500 ("cause of action merely requires that the [auditor] … concealed, or failed to act when required to do so, [thereby] enabl[ing the primary misconduct] to proceed." (internal quotations and citations omitted).

Further, the Thema Plaintiffs have sufficiently alleged that PwC was unjustly enriched at the class's expense in receiving fees for audits and other purported services that were, if performed at all, grossly deficient. *See* TC ¶¶ 539-43. Promising to perform, being paid to perform, and retaining payment despite not performing, is the classic case where it would be "against equity and good conscience to permit the defendant to retain what is sought to be recovered." *Paramount Film,* 285 N.E.2d at 698. That is precisely what Plaintiffs have alleged here. *See* TC ¶¶ 295-302; *see also Waldman*, 714 F. Supp. 2d at 404. PwC's arguments to the contrary, *see* Ryan Decl. at 4, are unavailing. *See Mfrs. Hanover*, 559 N.Y.S.2d at 708 (direct conveyance of benefit not required); *Carriafielo-Diehl & Assocs., Inc. v. D&M Elec. Contracting, Inc.*, 784 N.Y.S.2d 617, 618 (N.Y. App. Div. 2004) ("Nor does the fact that plaintiffs may have recourse against the [party who directly conferred benefit to defendants] preclude [] action against the allegedly unjustly enriched."); *Auguston*, 723 N.Y.S.2d at 106 (unjust enrichment may be pled in the alternative, thus purported contract cannot render claim insufficiently pled).

Finally, the Thema Plaintiffs allege sufficient involvement by each named international affiliate and, as further detailed below, the specific exercise of authority by PwCIL in PwC's audit, and thus adequately plead control. *See* TC ¶¶ 232-39, 240-46; *see also Cromer Fin. Ltd. v.*

Berger, Nos. 00 Civ. 2284(DLC), 00 Civ. 2498(DLC), 2002 WL 826847, at *8 (S.D.N.Y. May 2, 2002) (finding similar allegations sufficed to plead control of international parent of auditor that aided and abetted a Ponzi scheme). Moreover, the "level of control necessary to form a principal-agent relationship between a parent company and subsidiary defies resolution by mechanical formulae, for the inquiry is inherently fact-specific." *In re South African Apartheid Litig.*, 617 F. Supp. 2d 228, 272 (S.D.N.Y. 2009) (internal quotation omitted). Accordingly, any such a determination here would be premature, and, rather, "will have to await the litigation of the merits." *Cromer*, 2002 WL 826847, at *6.

D. Plaintiffs Have Adequately Stated Claims for Vicarious Liability

Plaintiffs have adequately alleged that PwC Bermuda, PwC Ireland, and PwC U.S. acted as agents of PwCIL and that EY Cayman and EY Lux acted as agents of EYG in conducting the audits and issuing the unqualified audit opinions on the Funds' financial statements, and thus PwCIL and EYG are liable for the torts their member firms committed. PwCIL and EYG cannot hold themselves out as unitary, global umbrella organizations with the right to control the conduct of their member firms so as to entice clients, and then deny that fact so as to avoid liability.[30]

To plead vicarious liability under New York law, Plaintiffs must allege that "an agency relationship results from a manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and the consent by the other to act." *N.Y. Marine & Gen. Ins. Co. v. Tradeline*, *(L.L.C.)*, 266 F.3d 112, 122 (2d Cir. 2001) (internal quotation omitted). To bind a principal, "an agent must have authority, whether apparent, actual or implied." *Merrill Lynch Interfunding*, *Inc. v. Argenti*, 155 F.3d 113, 122 (2d Cir. 1998). Actual

[30] For similar reasons, UCG and HSBC Holdings plc are each liable for the tortious acts of their subsidiaries. *See*, *e.g.*, HC ¶ 37-39. Plaintiffs have sued PGAM not for its vicarious liability for the conduct of its subsidiaries, but for its own conduct. *See supra* at Section IV.B.

authority "is created by direct manifestations from the principal to the agent." *Reiss v. Societe Centrale du Groupe des Assurances Nationales*, 235 F.3d 738, 748 (2d Cir. 2000) (citation omitted). The consent for actual authority may be either express or implied from "the parties' words and conduct as construed in light of the surrounding circumstances." *Riverside Research Inst. v. KMGA, Inc.*, 489 N.Y.S.2d 220, 220 (N.Y. App. Div. 1985), *aff'd*, 497 N.E.2d 669 (N.Y. 1986); *see also Minskoff v. Am. Express Travel Related Servs. Co.*, 98 F.3d 703, 708 (2d Cir. 1996). "[I]mplied actual authority … is dependent on verbal or other acts by a principal which reasonably give an appearance of authority" in a manner that is "brought home to the agent." *Greene v. Hellman*, 412 N.E.2d 1301, 1306 (N.Y. 1980).

Plaintiffs' agency allegations meet the notice pleading requirements of Rule 8. PwCIL and EYG are umbrella organizations which coordinate the accounting and auditing services for the various constituent PwC member firms. HC ¶¶ 514-520; PC ¶¶ 96-103; TC ¶¶ 231-39. PwCIL and EYG marketed themselves and their member firms as a single, unitary, global auditing firm and reported the revenue for all member firms on a combined basis. *Id.*

The Thema Complaint, for example, alleges that the Thema Fund's auditor, PwC Ireland, collaborated with PwC Bermuda and PwC U.S. to perform the Thema Fund audits. TC ¶ 231. PwCIL's literature and website collectively refer to these entities, along with PwC's other member firms, as "PricewaterhouseCoopers" or "PwC." TC ¶ 232. PwC's Global Annual Review, moreover, speaks of a single "global network" with "standards each PwC member firm is obliged to follow." TC ¶ 233. Additionally, PwC has a single Chairman and CEO. TC ¶ 234. It is governed by a single Network Leadership Team (effectively a board of directors) which "sets the strategy and standards that the PwC network will follow," and a Network Executive Team (effectively management) which comprises the key divisions of the global company. TC ¶¶ 235-36. Additionally, a Global Board "ensure[s] accountability, protect[s] the [PwCIL]

network, and ensure[s] effective governance." TC ¶ 237. A Strategy Council provides "strategic direction and ensures alignment in the execution of strategy." *Id.* These governance bodies are housed within PwCIL, which controls its agents through a series of agreements that govern and enforce standards across PwC member firms:

> Managing risk and quality. A firm's membership of the PwC network depends on its ability to comply with common risk and quality standards. … Territory Senior Partners sign an annual compliance confirmation with a set of risk management standards covering a range of risk areas. … These confirmations follow an assessment of compliance supported by local testing and quality review.

TC ¶ 238. Finally, PwC, like any other multinational corporation, reports the numbers of its staff and its annual revenues on a worldwide basis. TC ¶ 239 (2008 Global Annual Review reported that PwC had "more than 153,000 people in 53 countries" and generated "$28.2 billion in total worldwide revenues in 2008").

EYG is no different. E&Y's literature and website refer to EYG and its member firms, including EY Cayman and EY Lux, as "Ernst & Young" or "E&Y." PC ¶ 96; HC ¶ 514. E&Y's 2009 Global Annual Review speaks of "one strong global leadership team that sets one single global strategy and agenda." PC ¶ 97; HC ¶ 515. Like PwC, E&Y has one Chairman and CEO. PC ¶ 98; HC ¶ 516. Also like PwC, E&Y operates "as a global business with one shared strategy, led and overseen by a single management team." PC ¶ 99; HC ¶ 517. E&Y has a Global Executive (effectively a board of directors) chaired by the CEO; eight Global Executive Committees, which report to the Global Executive; a Global Practice Group, which "seeks to ensure common understanding across member firms of Ernst & Young's strategic objectives and consistency of execution across the organization"; and a Global Advisory Council, the "approval" of which "is required for a number of significant matters that could affect the organization." PC ¶ 100; HC ¶ 518. This global governance structure enforces consistency throughout E&Y; "[g]lobally consistent terms and conditions and statements of work means that

our global clients contract with our member firms in a consistent manner throughout the world." PC ¶ 101; HC ¶ 518. Finally, E&Y, like PwC, states in its Global Annual Review that it is composed of more than 144,000 people worldwide and generated $21.4 billion in total worldwide revenues in 2009. PC ¶ 103; HC ¶ 520.

These allegations sufficiently establish PwCIL's and EYG's vicarious liability at this stage. *See Cromer*, 2002 WL 826847, at *8; *In re Parmalat Sec. Litig.*, 474 F. Supp. 2d 547, 553-54 (S.D.N.Y. 2007).[31] At the pleading stage, the case law does not require that Plaintiffs allege that PwCIL or EYG were actually involved in performing the Funds' audits. Rather, it requires that the Complaints plead – as they do – sufficient facts to show that PwCIL and EYG exercised some control over their member firms' operations and audits generally. *See*, *e.g.*, *Cromer*, 2002 WL 826847, at *4. *In re Parmalat Sec. Litig.*, 375 F. Supp. 2d 278, 287-88, 293-95 (S.D.N.Y. 2005). Having chosen to portray, market and conduct themselves as controlling entities of the PwC and E&Y global networks, PwCIL and EYG cannot now, on a motion to dismiss no less, claim that they are not liable for the conduct of their member firms.[32]

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[31] 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*, No. 00 Civ. 5189(RCC), 2002 WL 498627, at *3-5 (S.D.N.Y. Mar. 29, 2002); *Toppel v. Marriott Int'l*, *Inc.*, No. 03 Civ. 3042(DAB), 2006 WL 2466247, at *7-8 (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." *In re Parmalat Sec. Litig.*, 375 F. Supp. 2d 278, 295 (S.D.N.Y. 2005).

[32] The three cases relied upon by Defendants – *In re Asia Pulp & Paper Sec. Litig.*, 293 F. Supp. 2d 391, 396 (S.D.N.Y. 2003); *Nuevo Mundo Holdings v. PricewaterhouseCoopers LLP*, No. 03 Civ. 0613, 2004 WL 112948, at *3 (S.D.N.Y. Jan. 22, 2004); and *Star Energy Corp. v. RSM Top-Audit*, No. 08 Civ. 00329, 2008 WL 5110919, at *5 (S.D.N.Y. Nov. 26, 2008) – are distinguishable. In *Asia Pulp*, the court dismissed a claim under Section 20(a) of the Securities Exchange Act, brought against Andersen Worldwide Société Coopérative ("AWSC"), because the "Amended Complaint is bereft of any allegations that AWSC, pursuant to an agreement or otherwise, was able to control or in any way influence the particular audits conducted or opinions offered by its individual member firms." *Asia Pulp*, 293 F. Supp. 2d at 396. In *Star Energy*, there was no executive overlap alleged between the principal auditing company and subsidiary and plaintiffs did not adequately allege the audit was subject to the principal's control. *Star Energy*, 2008 WL 5110919, at *4-5. In *Nuevo Mundo*, plaintiffs were asserting a vicarious

V. THE THEMA PLAINTIFFS ADEQUATELY PLEAD DERIVATIVE CLAIMS

In addition to Plaintiffs' direct claims, which seek to redress violations of duties owed to Plaintiffs personally, the Thema Plaintiffs have alleged derivative claims in the alternative as expressly permitted under Rule 8. *See* Fed. R. Civ. P. 8; *see also Adler v. Pataki*, 185 F.3d 35, 41 (2d Cir. 1999) (pursuant to Rule 8, at the motion to dismiss stage, plaintiffs may plead alternative claims "regardless of consistency").

A. *Foss v. Harbottle* Does Not Bar the Derivative Claims Alleged

Even if Irish law applied, Plaintiffs' derivative claims have been properly pled. A shareholder's standing to sue on behalf of a corporation under Irish law is governed by the rule in *Foss v. Harbottle*, 2 Hare 461 (Eng. 1843); *see also* J. Ryan Decl. ¶ 32; *In re Tyco Int'l*, *Ltd.*, 340 F. Supp. 2d 94, 98 (D.N.H. 2004). Plaintiffs' derivative claims are proper under at least two exceptions to this rule.

The "fraud on the minority [exception] requires Plaintiff to show that the alleged wrongdoers (1) control the company; and (2) committed 'fraud.'" *Feiner Family Trust v. VBI Corp.*, No. 07 Civ. 1914(RPP), 2007 WL 2615448, at *5 (S.D.N.Y. Sept. 11, 2007); *see also* J. Ryan Decl. ¶ 35-38. Both requirements are met here. TC ¶¶ 396-408. A "corporation's board of directors will be deemed to have control ... if the evidence demonstrates that it has acquired *de facto* control." *Tyco*, 340 F. Supp. 2d at 99; J. Ryan Decl. ¶ 36. "Fraud in this context does not have any element of dishonesty, [rather, it includes] "actions falling short of negligence." J. Ryan Decl. ¶ 36.

Here, the Thema Defendants completely control the Thema Fund. TC ¶¶ 396-408. In contrast, Thema shareholders have absolutely no control, cannot vote, and indeed have no say

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relationship between a Peruvian accounting firm and its U.S. affiliate based solely on allegations that they share a common name and the same parent company. *Nuevo Mundo*, 2004 WL 112948, at *3. In fact, the plaintiffs in *Nuevo Mundo* failed to allege that the U.S. affiliate had the right to control any aspects of the Peruvian firm's operations. *Id.* at *5.

whatsoever in Thema-related matters. *Id.* Thus, Defendants' exclusive decision-making powers and control of the Thema Fund certainly qualifies, at the very least, as *de facto* control. J. Ryan Decl. ¶ 36-37. Further, the Thema Defendants undeservedly dealt themselves tens of millions of dollars directly from the Thema Fund without performing any of the fiduciary roles or services to which they had expressly committed, the nonperformance of which resulted in the massive losses to shareholders alleged here. *Id.* These exorbitant unearned and undeserved fees served to maintain the Thema Defendants' dereliction of duty, thereby facilitating the massive detriment to the Thema Fund caused by Madoff's ongoing Ponzi scheme. Thus, the derivative claims are alleged against the Thema Defendants that "derived a benefit" by "breach[ing] their fiduciary duty," while "in control of the company," and accordingly qualify as a fraud on the minority. *See* TC ¶¶ 396-408.

Similarly, the Thema Defendants' active participation in, and reckless disregard of, the largest Ponzi scheme ever certainly constitute "*ultra vires* or illegal acts," which are exempt under *Foss v. Harbottle*. *Id.* This exception covers any "act contrary to statute, to the corporate by-laws, or to the directors' fiduciary obligations." *Messinger v. United Canso Oil and Gas Ltd.*, 486 F. Supp. 788, 795 (D. Conn. 1980); *see also* J. Ryan Decl. ¶ 36-37. Here, the Thema Complaint alleges myriad breaches of fiduciary and other duties, *see*, *e.g.*, TC ¶¶ 127-31, 132-47, 398-407 and Section VIII *infra*, and, moreover, details the Thema Defendants' reckless funneling of nearly all the assets of the Thema Fund to Madoff's massive Ponzi scheme instead of placing and managing the Funds according to the conservative standards marketed to, and relied on by, the aggrieved shareholder class. This *ultra vires* conduct renders *Foss v. Harbottle* inapplicable.

B. The Direct and Derivative Claims Alleged Pose No Conflict

Defendants' contention that the direct and derivative claims alleged render Mr. Davis

impermissibly conflicted, and thus an inadequate representative, fails as both procedurally premature and substantively unsound. The "claim of inconsistency and 'conflict of interests' cannot avail defendants at [the pleading] stage." *Heilbrunn v. Hanover Equities Corp.*, 259 F. Supp. 939 (S.D.N.Y. 1966) (holding direct and derivative claims can be pled in the alternative); *see also Levine v. Am. Export Indus., Inc.*, 473 F.2d 1008, 1009 (2d Cir. 1973) (purported conflict between direct and derivative claims did not warrant appraisal of adequacy of representation at pleading stage); *Miller v. Fisco, Inc.*, 63 F.R.D. 132, 134 (E.D. Pa. 1974) ("a finding of a conflict, while possibly appropriate on a class action determination, is premature at th[e pleading stage]") (citing *Heilbrun*, 259 F. Supp. 936).

Moreover, even if the Court considers the Thema Defendants' premature contention, it is still to no avail; district courts in this Circuit have long recognized that there is no "*per se* rule against contemporaneous derivative and direct class suits." *Brickman v. Tyco Toys, Inc.*, 731 F. Supp. 101, 109 (S.D.N.Y. 1990); *Heilbrun*, 259 F. Supp. at 938 (there is no "fatal inconsistency between plaintiffs' role as protectors and prosecutors of the corporation's interests"); *Grace v. Rosenstock*, No. 85 Civ. 2039, 1986 WL 2709, at *3 (E.D.N.Y. Mar. 6, 1986) ("class and derivative actions represented by the same plaintiff and counsel are not inherently precluded"). To the contrary, courts have repeatedly warned against "let[ting] the surface duality blind" one to the fact that such actions have "a basic goal which entails no real inconsistencies." *Kane Assocs. v. Clifford*, 80 F.R.D. 402, 408 (E.D.N.Y. 1978) (internal quotation omitted). Accordingly, dual prosecutions are routinely allowed "where the primary and derivative suits are not truly at odds with each other." *Kamerman v. Pakco Co.,* No. 76 Civ. 3912-CSH, 1978 U.S. Dist. LEXIS 19700, at *5 n.3 (S.D.N.Y. Feb. 6, 1978); *Kamerman v. Pakco Co.*, 113 F.R.D. 511, 515-16 (S.D.N.Y. 1986).

Here, "any antagonism between plaintiffs suing as representatives of the class and derivatively on behalf of the corporation are no more than a 'surface duality.'" *Grace*, 1986 WL 2709, at *3 (quoting *Bertozzi v. King Louie Int'l, Inc.*, 420 F. Supp. 116, 1180 (D.R.I. 1976)). Because "Plaintiff seeks to represent all shareholders of [Thema] except the individual defendants ... a recovery for the corporation and a recovery for the shareholders would amount to a recovery for the same parties and no conflict should exist." *Miller*, 63 F.R.D. at 134 (citing *Heilbrun*, 259 F. Supp. 936). Where, as here, the "underlying facts ... show no conflict, but indicate a common interest arising out of a common nucleus of facts," a court "cannot find [] plaintiffs inadequate representatives simply on the ground that they have sued derivatively." *Kane*, 80 F.R.D. at 408-09.

VI. PLAINTIFFS' COMMON LAW CLAIMS ARE NOT PREEMPTED

A. SLUSA Does Not Preempt Plaintiffs' Common Law Claims

Defendants incorrectly contend that "all of [Plaintiffs'] common law claims are barred by SLUSA." Def. Br. at 18-20. SLUSA's preclusive reach is limited;[33] it only "bars class actions of fifty or more members 'based upon the statutory or common law of any State' that allege 'a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security,'" *i.e.*, that sound in fraud. *Anwar II*, 728 F. Supp. 2d at 398 (quoting 15 U.S.C. § 78bb(f)(1)(A)). Here, Plaintiffs' claims fall outside SLUSA's limited reach in at least three critical respects: (1) the Supreme Court recently held that U.S. securities laws do not reach overseas investments in overseas funds; (2) the securities at issue are not "covered securities";

[33] SLUSA's sole intent was to close a perceived "loophole" that allowed securities fraud cases to be filed as state court class actions so as to avoid the heightened pleading requirements and limitations on early discovery under the PSLRA. *See Spielman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 332 F.3d 116, 123 (2d Cir. 2003). SLUSA was never intended to create new and significant incursions into areas traditionally reserved for longstanding common law remedies. "[B]ecause the States are independent sovereigns in our federal system, [courts] have long presumed that Congress does not cavalierly pre-empt state-law causes of action." *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485 (1996).

(3) the conduct alleged does not meet SLUSA's "in connection with" requirement; and (4) the Thema Plaintiffs' claims do not sound in fraud. Each of these flaws is independently fatal to Defendants' blanket contention.[34]

1. SLUSA Does Not Apply To Securities Purchased Abroad

On June 24, 2010, the Supreme Court issued its opinion in *Morrison v. National Australia Bank Ltd.*, 130 S. Ct. 2869 (2010), holding that the federal securities laws are limited to securities transactions that take place in the United States. Specifically, the Supreme Court announced a clear "transactional test"— "*whether the purchase or sale is made in the United States*, *or involves a security listed on a domestic exchange*." *Id.* at 2886 (emphasis added). Thus, post-*Morrison*, U.S. securities laws apply only to "transactions in securities listed on domestic exchanges, and domestic transactions in other securities." *Id.* at 2884.

Since *Morrison*, this Court, along with other courts in this District and elsewhere, have uniformly dismissed federal securities claims where plaintiffs failed to allege a domestic securities transaction — that, post-*Morrison*, being an essential element of any such claim. *See*, *e.g.*, *In re Société Générale Sec. Litig.*, No. 08 Civ. 2495(RMB), 2010 U.S. Dist. LEXIS 107719, at *17-18 (S.D.N.Y. Sept. 29, 2010) (Berman, J.).

Here, despite Defendants' arguments that SLUSA and the Private Securities Litigation Reform Act ("PSLRA") preclude Plaintiffs from alleging state law claims or RICO violations,

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[34] Even if the Court were to conclude that some of Plaintiffs' common law claims are precluded by SLUSA – which they are not – the remaining, non-SLUSA claims could not be dismissed. *See Dabit v. Merrill Lynch*, *Pierce*, *Fenner & Smith*, *Inc.*, 395 F.3d 25, 47 (2d Cir. 2005), *rev'd on other grounds*, 547 U.S. 71 (2006) ("SLUSA's language and legislative history indicate no intent to preempt categories of state action that do not represent 'federal flight' litigation."); *see also LaSala,* 510 F. Supp. 2d at 274-75 (*Dabit* remains law of Circuit); *In re Lord Abbott Mut. Funds Fee Litig.*, 553 F.3d 248, 255-56 (3rd Cir. 2009) ("To require the dismissal of all of the other claims in the same action ... is not supported by the plain language or legislative history. We hold therefore that SLUSA does not mandate dismissal of an action in its entirety where the action includes only some pre-empted claims.").

Plaintiffs' transactions are beyond the reach of the U.S. securities laws. Because Plaintiffs have not made a "purchase or sale … in the United States" or a purchase or sale of "a security listed on a domestic exchange[,]" U.S. securities laws do not apply. *Morrison*, 130 S. Ct. at 2886. It is undisputed that Plaintiffs are foreigners and that every transaction by each of the Plaintiffs took place outside the United States. Under *Morrison*'s "bright line rule," "the foreign location of the transaction[s]" at issue prevents Defendants from raising defenses created by U.S. securities laws just as it prevents Plaintiffs from alleging violations of U.S. securities laws. *Id.* at 2885.

Defendants may argue for a narrow reading of *Morrison*, claiming that *Morrison* is strictly limited to Section 10(b) of the Exchange Act and does not apply to any other statutory provision. This argument is undercut, however, by Defendants' arguments that *Morrison* should apply to the Herald Plaintiffs' RICO claims. Def. Br. at 41. Certainly if *Morrison* applies to RICO, it must also apply to other provisions of this country's securities laws. In any event, by inserting the phrase "in connection with the purchase or sale" into SLUSA's core provision, not only did Congress use the same words as it used in Section 10(b) and Rule 10b-5, but it used them in a provision that appears in the very same statute as Section 10(b). As SLUSA's core provision is in the Exchange Act, and "the focus of the Exchange Act is not upon the place where the deception originated, but upon purchases and sales of securities in the United States," 130 S. Ct. at 2884, then it stands to reason that SLUSA's focus is also on purchases and sales of securities in the United States.

2. This Case Does Not Concern Covered Securities

Defendants' legal argument – both as to whether "covered securities" are at issue and as to the "in connection with" requirement – turns on an out-of-context quotation from the Supreme Court in *Dabit v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, 547 U.S. 71, 85 (2006) (citing *United States v. O'Hagan*, 521 U.S. 642, 651 (1997)), that "it is enough that the fraud alleged

‘coincide’ with a securities transaction – whether by the plaintiff or by someone else.” *See* Def. Br. at 19.[35] In *Dabit*, the Supreme Court clarified its holding in *SEC v. Zandford*, 535 U.S. 813 (2002), by stating that the requisite showing of deception could be in connection with the purchase or sale of a security, and not just deception of a particular purchaser or seller. *Dabit*, 547 U.S. at 85.[36] In *Dabit*, the Supreme Court did not need to look any further than the deception practiced by Merrill Lynch analysts in publishing misleading reports that proximately caused investors’ losses, and used the “coincides with” terminology only in ruling that SLUSA applies to holders, as well as purchasers and sellers, of “covered securities.” Just as in *Dabit*, this Court need – and should – look no further than Plaintiffs’ direct dealings with Defendants, which caused Plaintiffs’ losses through purchases of the non-covered Funds. It is the securities actually purchased, sold, or held, and about which Plaintiffs complain, that are relevant for purposes of SLUSA. *See*, *e.g.*, *Pension Comm. of the Univ. of Montreal Pension Plan v. Banc of*

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[35] Courts have warned against taking *Dabit* beyond its logical extreme, which is what Defendants are attempting here. *See*, *e.g.*, *Gavin v. AT&T Corp.*, 464 F.3d 634, 639-40 (7th Cir. 2006) (“the ‘connection’ requirement must be taken seriously.” “Of course there is a literal sense in which anything that happens that would not have happened but for some prior event is connected to that event. ... in the same sense the fraud is connected to the Big Bang.” (citation omitted)); *Drulias v. Ade Corp.*, No. 06-11033PBS, 2006 WL 1766502, at *2 (D. Mass. June 26, 2006) (“While the Supreme Court recently embraced a broad interpretation of SLUSA, it did not suggest that all claims of breach of fiduciary duty in connection with the purchase or sale of securities are sucked into the SLUSA sluice.”); *Falkowski v. Imation Corp.*, 309 F.3d 1123, 1131 (9th Cir. 2002) (“garden variety state law claims ... are not preempted by federal securities laws”).

[36] In *Zandford v. SEC* the court did not consider SLUSA, but instead addressed the proper scope of the “in connection with” requirement under other federal securities laws. In limiting the theoretical reach of that phrase, the court noted: “our analysis does not transform every breach of fiduciary duty into a federal securities violation. If ... a broker embezzles cash from a client’s account ... then the fraud would not include the requisite connection to a purchase or sale of securities.” 535 U.S. 813, 825 n.4 (2002). Madoff’s conduct with respect to the Funds is certainly analogous.

Am. Sec. LLC, 750 F. Supp. 2d 450, 754-55 (S.D.N.Y. 2010); *Anwar II*, 728 F. Supp. 2d at 398-99.[37]

SLUSA cannot preclude the claims alleged because none of the securities at issue in this case are "covered" securities. 15 U.S.C. § 77r(b)(1); *Dabit*, 547 U.S. at 83. A "covered security is one traded nationally and listed on a regulated national exchange." 547 U.S. at 83; *see also* 15 U.S.C. § 77r(b)(1)(A) ("covered security" is limited to securities "listed ... on the New York Stock Exchange or the American Stock Exchange, or ... on the National Market System of the Nasdaq Stock Market"). Whether the securities at issue are covered under SLUSA necessarily depends on <u>the securities that actually exist, that Plaintiffs purchased, and about which Plaintiffs complain</u>. *See Anwar II*, 728 F. Supp. 2d at 398-99 (SLUSA inapplicable to shares of Madoff feeder fund because "at the heart of this case are the non-covered interests in the Funds" (citation omitted)); *Pension Comm.*, 750 F. Supp. 2d at 453-54 (investments in non-covered funds, even when the funds indisputably invest in covered securities, do not implicate SLUSA).

The claims alleged here are based exclusively on shares in the Funds, none of which ever traded on a national exchange.[38] *See, e.g.,* HC ¶¶ 7, 10, 15; TC ¶¶ 27-28. Only these non-covered Fund shares, and Defendants' failure to fulfill professional and fiduciary duties to monitor the Funds that issued them and to deliver accurate information regarding their

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[37] Defendants present a hodge-podge of inapposite citations to cases in which the factual circumstances are readily distinguishable from the present case. In all such cases where the relationship between the parties fell within the ambit of SLUSA preclusion, there was at least a direct relationship between the plaintiff and the alleged fraudster or its agent purporting to sell "covered securities." No such connection exists here between Plaintiffs and Madoff or BLMIS. *See*, *e.g.*, *Instituto de Prevision Militar v. Merrill Lynch*, 546 F.3d 1340, 1350 (11th Cir. 2008) (SLUSA applied where plaintiff alleged that Merrill Lynch was responsible for fraudster PFA's conduct because it allowed PFA to portray itself as Merrill Lynch's agent while soliciting plaintiff to buy covered securities); *Schnorr v. Schubert*, No. 05-303-M, 2005 WL 2019878, at *4 n.11 (W.D. Okla. Aug. 18, 2005) (SLUSA applied where Ponzi scheme operator made false representations regarding investments in covered securities directly to plaintiff who invested with the fraudster).

[38] Indeed, Defendants concede that "the securities at issue were not traded in an open, efficient market." Def. Br. at 17 n. 17.

investment performance, are at issue. *See, e.g.,* HC ¶¶ 7, 22, 53, 534, 662-72, 674-81, 683-90, 692-97, 699-703, 706, 713-19, 721-27, 729-34, 736-46, 748-55, 758-65; TC ¶¶ 4-10. Only these non-covered securities were listed in the account statements Defendants regularly sent Plaintiffs. *See*, *e.g*., HC ¶¶ 158-59, 494, 509, 667, 678, 687, 788, 790; TC ¶¶ 102-03. Only these non-covered securities were ever bought, held or sold in the dealings underlying this action. Indeed, the only "securities" that ever *actually existed* were those in the Funds sold to Plaintiffs. *See, e.g.*, HC ¶¶ 447, 492, 511-12, 551-53, 560. *Id.* Thus, because no covered securities are at issue, SLUSA preclusion is wholly inapplicable. *See Anwar II*, 728 F. Supp. 2d at 398-99.

Defendants attempt to sidestep this inconvenient truth by pointing to the purported "covered securities" that Madoff was supposed to have purchased through BLMIS but never did. Def. Br. at 20. Defendants' argument ignores critical and dispositive facts: Plaintiffs never invested with Madoff or BLMIS. Plaintiffs never even knew of Madoff prior to his arrest, much less that he alone was purportedly fulfilling the myriad functions, roles, and responsibilities to which Defendants had committed. And critically, Madoff *never purchased* Defendants' imaginary "covered securities." Rather, Plaintiffs invested in the non-covered securities issued by the Funds in reliance on Defendants' representations and commitments to perform a variety of roles, audits, and custodial duties. At each step in the chain of events between Plaintiffs' purchase of non-covered Fund securities and Madoff's eventual theft of investor monies, Defendants had independent contractual and legal duties and it is Defendants' failure to fulfill those duties that is the basis of Plaintiffs' claims. Where no "covered security" is at issue, federal law is not affected by, and Plaintiffs should not be precluded from asserting, state law remedies.

3. SLUSA's "In Connection With" Requirement Is Not Met

Defendants' argument concerning the standard for the "connection" nexus rests on a similarly flawed attempt to expand *Dabit*'s "coincide with" standard beyond all bounds of reasonable statutory construction and common sense. Defendants mistake SLUSA as subsuming any tort or contract claim involving a securities firm. Def. Br. at 18-20. This argument is indefensible in light of the actual pleadings. Plaintiffs do not allege that they had any contact with Madoff or BLMIS or that they relied on anyone other than Defendants in purchasing and holding the Funds' securities. Rather, the claims focus on Defendants' conduct, not Madoff's.

Plaintiffs' interpretation of SLUSA in this regard is supported by Judge Scheindlin's decision in *Pension Comm.,* 750 F. Supp. 2d at 450. In *Pension Comm.*, investors in two Bahamian hedge funds sued to recover losses stemming from the funds' liquidation. As in the instant case, the plaintiffs there alleged, *inter alia*, that the defendants had prepared and distributed false valuations and other performance data for the funds. As here, the defendants argued that because those funds had in turn purchased covered securities, SLUSA preclusion applied under *Dabit*. *Pension Comm.*, 750 F. Supp. 2d at 453-54. The court held, however, that "[o]nly the alleged misstatements by the [] Defendants are relevant for an analysis of SLUSA preemption," and since those alleged misstatements only concerned the valuation of the funds, they were not made in connection with the purchase or sale of covered securities. *Id*.

Here, as in *Pension Comm.*, "[b]ecause plaintiffs purchased shares in [non-covered] funds, rather than covered securities, SLUSA does not preempt Plaintiffs' state-law claims." *Pension Comm.*, 750 F. Supp. 2d at 453-54. In reaching this conclusion, Judge Scheindlin refused "to look beyond SLUSA's plain meaning and hold that the Defendants' alleged untrue statements concerning the Funds were made in connection with the purchase or sale of covered securities," and concluded:

> The interpretation of SLUSA urged by the [defendants] stretches the statute beyond its plain meaning. There are no grounds on which to justify applying *Dabit* to statements made by the [defendants] concerning uncovered hedge funds – even when a portion of the assets in those funds include covered securities. This outcome is required because the alleged fraud relates to those hedge funds rather than the covered securities in the portfolios.

Id. at 455. As the court noted, "It is for Congress, not this Court, to extend SLUSA's 'in connection with' requirement to apply to untrue statements concerning the purchase, sale, and holding of shares of unregistered hedge funds like the Funds at issue here." *Id.* at 456; *see also Anwar II*, 728 F. Supp. 2d at 398-99; *Brehm v. Capital Growth Fin.*, *Inc.*, No. 8:07CV315, 2008 WL 553238, at *2 (D. Neb. Feb. 25, 2008) (no SLUSA preemption where plaintiffs alleged that they were induced to purchase private placements and debentures by omissions made by defendants "by means of a facility of a national securities exchange" where there was no additional showing that such exchange had listing requirements commensurate with required SLUSA "covered security" standards).[39]

The decisions Defendants cite applying SLUSA in the context of Madoff investments are unpersuasive here. In both *Backus v. Connecticut Community Bank*, *N.A.*, No. 3:09-CV-1256, 2009 WL 5184360 (D. Conn. Dec. 23, 2009); and *Levinson v. PSCC Services*, *Inc.*, No. 3:09-

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[39] Without undertaking the thorough analysis of the SLUSA issue in *Pension Comm.*, and without even citing that decision, Judge Griesa *in Barron v. Igolnikov*, No. 09 Civ. 4471(TPG), 2010 WL 882890, at *1-6 (S.D.N.Y. Mar. 10, 2010), held that SLUSA did preempt all state law claims against the manager and associated individuals of several Madoff feeder finds. The *Barron* opinion ignores the factual distinctions discussed herein, and its reasoning boils down to stating that the Supreme Court has "command[ed] that SLUSA be construed expansively," *id.* at *5 (which, as shown above, is wrong), and then stating, as an *ipse dixit* with no case support, that while the plaintiff class purchased only shares of non-covered hedge finds (just as in *Pension Comm.*), "which in turn invested in covered securities – rather than [purchasing] covered securities directly from Madoff, SLUSA preemption is justified because the securities transaction need not have been performed by plaintiff." *Id.* at *5. Plaintiffs respectfully submit that this interpretation is wrong on the facts and wrong on the law. It would stretch the words "in connection with" beyond all reasonable intent of the statutory language to apply it in the context of the Madoff fraud and Defendants' defalcations in this case. The better-reasoned and better-supported view is that expressed in *Pension Comm.* The *Barron* decision is on appeal to the Second Circuit, where it is fully briefed, argued, and awaiting decision. *Barron v. Igolnikov*, No. 10-1387 (2d Cir. Apr. 13, 2010).

CV-00269(PCD), 2009 WL 5184363 (D. Conn. Dec. 23, 2009), the plaintiffs were effectively direct investors in the Madoff fraud by means of collective investment accounts that were created by the defendants; there were no separate legal entities such as the Funds that were supposedly independently managed and purporting, but failing, to perform their own due diligence. Indeed, in *Levinson*, it was alleged that the defendants actually conspired with Madoff. Accordingly, in those cases, the links between the plaintiffs' claims, the defendants, and Madoff were much closer than the attenuated relationship that exists here. As was aptly observed in *Pension Comm.*, "[u]nlike *Backus* ... the covered securities are not 'at the heart' of this case. The purchase and sale of the *Funds'* shares are at the heart of this case." 750 F. Supp. 2d at 455 (emphasis in original).[40]

4. The Thema Plaintiffs' Claims Do Not Sound In Fraud

"In this Circuit, in order to be preempted by SLUSA, the claim must sound in fraud." *LaSala v. Bank of Cyprus Pub. Co.*, 510 F. Supp. 2d 246, 274-75 (S.D.N.Y. 2007); *Xpedior Creditor Trust v. Credit Suisse First Boston (USA) Inc.*, 341 F. Supp. 2d 258, 268 (S.D.N.Y. 2004). A claim sounds in fraud only when "the plaintiff alleges fraud as an integral part of the conduct giving rise to the claim." *Xpedior*, 341 F. Supp. 2d at 269. Claims that "require no evidence of [] mental state" "do not sound in fraud." *Id.* Thus, a court may "dismiss under SLUSA only claims that include misstatements or omissions as a necessary component." *Anwar II*, 728 F. Supp. 2d at 398 n.7 (internal quotations omitted).

[40] Defendants have argued that Plaintiffs' common law claims are governed by Irish, Cayman, or Luxembourgian law. If the Court were to adopt this view (which Plaintiffs submit is incorrect, *see* Section II.B.1-3.), then SLUSA by its terms would not apply. Under the statute's so called "Delaware carve-out" provision, class actions are exempted from SLUSA if the claims are brought under the law of the state of the issuer's incorporation (here, the Funds are incorporated in Ireland, Cayman Islands, or Luxembourg) and involve the purchase or sale of securities by the issuer to or from holders of the issuer's equity securities (here, the plaintiff classes). *See* 15 U.S.C. § 78bb(f)(3)(A)(i), (ii)(I). That is precisely the nature of the common law claims in this case if Defendants' choice-of-law arguments are accepted. Accordingly, the "Delaware carve-out" would apply to exempt all of Plaintiffs' common law claims from SLUSA.

The Thema Plaintiffs do not plead any misstatements or omissions. *See* ¶¶ 132-368. Nor is any misstatement or omission a necessary component of any of the claims asserted in the Thema Complaint. *See* ¶¶ 417-543. Indeed, none of the Thema Plaintiffs' claims depend on evidence of mental state because they stand solely on allegations that the Thema Defendants failed to satisfy duties owed to Thema investors, imposed by law or business practice and without regard to whether the Thema Defendants misrepresented any facts. *See id.* The Thema Plaintiffs' claims, *e.g.*, negligence, breach of fiduciary duty, breach of contract, constructive trust, and unjust enrichment, cannot be recast as fraud claims. *See MD CM Holdings, Inc. v. Credit Suisse First Boston Corp.*, 216 F. Supp. 2d 251, 257 n.12 (S.D.N.Y. 2002) (cautioning that in interpreting SLUSA, courts should consider what plaintiffs in fact allege and not what they could have alleged). As in *Xpedior*, because the Thema Complaint here "alleges only that [Defendants] acted contrary to [such] express and implied duties," the Thema Plaintiffs' "claims do not sound in fraud." *Xpedior*, 341 F. Supp. 2d at 269. Thus, SLUSA cannot preempt any claims asserted in the Thema Complaint.

B. The Martin Act Does Not Bar Plaintiffs' Common Law Claims

1. The Martin Act Does Not Preempt Common Law Claims that Do Not Allege Violation of the Act or Its Implementing Regulations

In an exhaustive recent opinion that rejected Martin Act[41] preemption in the context of Madoff feeder-fund litigation, Judge Marrero painstakingly analyzed and refuted all of the arguments propounded by Defendants here. *See Anwar v. Fairfield Greenwich Ltd.*, 728 F. Supp. 2d 354 (S.D.N.Y. 2010) ("*Anwar I*"). In particular, Judge Marrero carefully explained

[41] The Martin Act, N.Y. Gen. Bus. Law, §§ 352-59, was passed in 1921. Its purpose, among others, was to grant the New York Attorney General jurisdiction to investigate and prosecute "fraud, deception, concealment, suppression, false pretense or fictitious or pretended purchase or sale" with respect to securities transactions. The Act contains no language that expressly or implicitly preempts common law causes of action, nor have Defendants advanced any policy rationale why the New York legislature, in augmenting the Attorney General's authority, would seek to preclude private common law actions.

how and why many judges in this District have misread New York state cases to find preemption and in later decisions perpetuated that fallacious reasoning. *Id*. at 355, 365 ("[A]n error … becomes perpetuated when the fallacy is uncritically adopted and copied.… [T]he snake has eaten its own tail and many courts apply preemption simply by citing to other decisions that have found preemption, without examining whether the doctrine was warranted in the first place."). Though Defendants halfheartedly attempt to perpetuate the myth that was Martin Act preemption, in light of Judge Marrero's comprehensive analysis of these issues, to which Plaintiffs respectfully refer the Court, we will not address them at length.

Plaintiffs do note, however, that subsequent to Judge Marrero's excoriation of supposed Martin Act preemption, the First Department of the New York Appellate Division, agreeing with the position of the New York Attorney General, fully concurred with Judge Marrero's decision, confirming that Martin Act preemption, as applied to claims that do not specifically arise under the Martin Act itself, simply does not exist and never did. The New York state courts set the record straight by issuing two clear and unequivocal decisions holding that "***there is nothing in the plain language of the Martin Act*, *its legislative history or appellate level decisions in this State that supports defendant's argument that the act preempts otherwise validly pleaded common-law causes of action.***" *Assured Guar. (UK) Ltd. v. J.P. Morgan Inv. Mgmt. Inc.*, 915 N.Y.S.2d 7, 15 (N.Y. App. Div. 2010) (emphasis added); *CMMF LLC*, 2010 N.Y. App. Div. LEXIS 8747, at *2.

Moreover, *Assured Guaranty* and *CMMF* were decided in line with the advocated position of the New York Attorney General, which filed *amicus* briefs in those cases.[42] The New York Attorney General has filed a similar brief in the Second Circuit in an appeal of a pre-

[42] *Assured Guar. (UK) Ltd. v. J.P. Morgan Inv. Mgmt. Inc.*, Index No. 603755/08 (N.Y. App. Div. Apr. 7, 2010) and *CMMF*, *LLC v. J.P. Morgan Inv. Mgmt.*, *Inc.*, Index No. 601924/09 (N.Y. App. Div. Apr. 7, 2010).

Assured Guaranty decision from this District on which Defendants rely – *Barron v. Igolnikov*, No. 09 Civ. 4471(TPG), 2010 WL 882890 (S.D.N.Y. Mar. 10, 2010).[43] Where there is uncertainty as to an issue of state law (though there should not be at this point), the Attorney General's position on an issue of state law is "entitled to great weight." *See Phyle v. Duffy*, 334 U.S. 431, 441 (1948).

In a footnote, however, Defendants attempt to downplay this clear message from the New York Attorney General and the First Department, and assert that *Castellano v. Young & Rubicam, Inc.*, 257 F.3d 171 (2d Cir. 2001), should still portend how the New York Court of Appeals would decide the issue. Def. Br. at 21 n.21. Defendants' footnoted assertion lacks merit for two reasons. First, *Castellano* is not controlling on an issue of state law. *See Arizonans for Official English v. Arizona*, 520 U.S. 43, 48 (1997) ("Federal courts lack competence to rule definitively on the meaning of state legislation."). Thus, "in every case" district courts are duty bound to ascertain and apply state law as it *presently* exists, "however much the state rule may have departed from prior decisions of the federal courts." *West v. AT&T Co.*, 311 U.S. 223, 236-37 (1940). Where, as here, a state's highest court has not yet determined a question of state law, "[a]n intermediate state court in declaring and applying the state law ... should be followed by a federal court in deciding a state question." *Fidelity Union Trust Co. v. Field*, 311 U.S. 169, 177 (1940). Accordingly, the First Department's *Assured Guaranty* is controlling. *See Jaworski v. Ciasulli*, 490 F.3d 331, 333 (3rd. Cir. 2007) ("To wait for the [State] Supreme Court to reach an issue ... would be to abdicate our responsibility, while sitting in diversity."). Second, in any event, *Castellano* adopted the rule of the First Department on Martin Act preemption, as another court in this District noted in a recent case decided prior to *Assured*

[43] *See* Brief for the Attorney General of the State of New York as *Amicus Curiae* in *Barron v. Igolnikov*, No. 10-1387-cv (2d Cir. Aug. 13, 2010), on appeal from *Barron*, 2010 WL 882890 (Griesa, J.) (Attached as Bunch Decl. Ex. A).

Guaranty and *CMMF*. Citing to *Abu Dhabi Commercial Bank v. Morgan Stanley & Co., Inc.*, 651 F. Supp. 2d 155, 181 (S.D.N.Y. 2009), Judge Griesa recognized in *Tremont*, 747 F. Supp. 2d 406, and *Barron*, 2010 WL 882890, that "the Second Circuit has adopted the First Department's rule" concerning Martin Act preemption, and that "argument – drawn from case law outside the First Department – is thus insufficiently persuasive." *Tremont*, 747 F. Supp. 2d at 415. Now that the First Department in *Assured Guaranty* and *CMMF* has unequivocally ruled that the Martin Act does not preempt common law tort claims in the securities context, Plaintiffs' claims here must survive.

2. Alternatively, the Martin Act Does Not Apply Because Securities Were Not Sold "Within or From" New York

Even if this Court were to recognize Martin Act preemption, Plaintiffs' claims should not be dismissed because Defendants here did not issue, sell or distribute securities to Plaintiffs "within or from" New York to the extent necessary to apply the Act to Defendants' conduct. *See* N.Y. Gen. Bus. Law §352-(c)(1)(c); *Nanopierce Techs., Inc. v. Southridge Capital Mgmt. LLC*, No. 02 Civ. 0767(LBS), 2003 WL 22052894, at *6 (S.D.N.Y. Sept. 2, 2003) (declining to dismiss breach of fiduciary duty claim as preempted by the Martin Act because securities in question were not offered for sale within or from New York). Rather, this is a case which challenges the sale and marketing of the Funds – as Defendants are quick to argue in other areas of their brief, including the very first line of their preliminary statement – to Plaintiffs who reside outside of the United States.

Where, as here, "the conduct was not confined to New York and [] some plaintiffs may have interacted with defendants exclusively outside of New York," Martin Act preemption does not apply. *See, e.g.*, *Robeco-Sage Capital, L.P. v. Citigroup Alt. Invs. LLC,* No. 601030/2008, 2009 WL 2626244, at *18 (N.Y. Sup. Ct. July 28, 2009) ("because the solicitation of subscriptions in the CSO Funds was not confined to New York but largely took place in Cayman

Islands, their interests do not relate to the solicitation and purchase of securities 'within or from New York'" (citing to *Fraternity Fund Ltd. v. Beacon Hill Asset Mgmt., LLC,* 376 F. Supp. 2d 385, 410 (S.D.N.Y. 2005)); *Pension Comm. of the Univ. of Montreal Pension Plan v. Banc of Am. Sec., LLC*, 592 F. Supp. 2d 608, 639-40 (S.D.N.Y. 2009) (claims for breach of fiduciary duty and negligence not barred because, "[a]lthough the Citco Defendants communicated regularly with Lauer in New York, they performed most of their work for the Funds in Curacao, Netherlands Antilles"). In *Pension Committee*, 592 F. Supp. 2d 608, the court held that the Martin Act was inapplicable where "the securities were mostly marketed and sold to foreign investors, and only a limited number of investors in the United States participated." *Id.* at 639-40 (citing *Lehman Bros. Commercial Corp. v. Minmetals Int'l Non-Ferrous Metals Trading Co.*, 179 F. Supp. 2d 159, 165 (S.D.N.Y. 2001) (Martin Act did not apply where negotiations occurred between traders in London and Hong Kong and investor in Beijing)).[44]

VII. PLAINTIFFS HAVE STANDING TO PURSUE THEIR CLAIMS

For naught, Defendants attempt to undermine Plaintiffs' standing by mischaracterizing their direct claims alleged as "necessarily derivative." Def. Br. at 22. Under governing New York law,[45] "a shareholder may bring an individual suit if the defendant has violated an

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[44] The fact that application of New York substantive law is appropriate here given that substantial wrongdoing at the core of the claims occurred in New York, *see* Section II.A., *supra*, does not impact the construction of the Martin Act's language ("within or from"), which looks to where the offending sales at issue took place. Where activity occurs both within and outside New York, as here, Plaintiffs' foreign presence renders the Act inapplicable.

[45] A "federal court adjudicating a state law claim must apply the choice of law principles of the forum state." *Norlin Corp. v. Rooney*, *Pace Inc.*, 744 F.2d 255, 263 (2d Cir. 1984) (citing *Klaxon Co. v. Stentor Elec. Mfg. Co.*, *Inc.*, 313 U.S. 487, 496 (1941)). New York, and the Second Circuit, have "rejected any automatic application of the so-called internal affairs choice-of-law rule." *Id*. (internal quotation omitted); *Greenspun v. Lindley*, 330 N.E.2d 79 (N.Y. 1975)). "Rather, New York uses an interest analysis generally applying the law of the jurisdiction with the greatest interest in the specific issue under consideration." *Koury v. Xcellence Inc.*, 649 F. Supp. 2d 127, 135 (S.D.N.Y. 2009); *Zurich Ins. Co. v. Shearson Lehman Hutton*, *Inc.*, 642 N.E.2d 1065, 1068 (N.Y. 1994). As in *Pension Comm.*,"[b]ecause occurrences in New York and the parties'contacts with that forum bear the most relation to the [claims] at

independent duty to the shareholder, whether or not the corporation may also bring an action." *Ceribelli v. Elghanayan*, 990 F.2d 62, 63-64 (2d Cir. 1993) (citations omitted). Here, the claims allege Defendants, as supposedly independent fund service providers and fiduciaries, utterly failed to fulfill their duties to Plaintiffs. Such "allegations by investors of having been tortiously induced to invest or to retain an investment are not derivative claims." *Anwar II*, 728 F. Supp. 2d at 401; *Pension Comm.*, 446 F. Supp. 2d at 205. And even if "some mismanagement and self-dealing ... may have been involved," where, as here, the "principal wrong ... injured plaintiffs," direct action must be allowed. *Fraternity Fund*, 376 F. Supp. 2d at 408-09; *accord Anwar II*, 728 F. Supp. 2d at 400-01. In this regard, the present case mirrors *Anwar II*:

> At its core, this case alleges claims against the corporate entities and individuals responsible for [leading] Plaintiffs to make and maintain investments in the Funds which, though nominally corporate, were merely vessels for ferrying the investments to Madoff. [Because these] breaches of duty were essential to the Funds' corporate forms thriving as substantially all of the Funds' assets were invested with Madoff ... the alleged concealment … did not harm the Funds as such. Rather ... Defendants' errors ... sustained their corporations. Without ... [the] wrongs alleged in this action, the Funds would not have even existed.

728 F. Supp. 2d at 401. These claims accrue to injured shareholders, not to guilty corporate shells, and are thus direct, not derivative. *Id.* ("The Court is not inclined to limit liability to the corporate entity that allegedly functioned essentially as a vehicle for harming Plaintiffs."); *see*

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issue here, New York has the greatest interest in applying its law." 446 F. Supp. 2d at 194-95 (New York law applied where defendants "communicated regularly" with parties and offices in New York); *see also Anwar II*, 728 F. Supp. 2d at 400 (New York law applied to Madoff feeder funds); *Cromer Fin. Ltd.*, 137 F. Supp. 2d at 492 (New York law applied to claims by plaintiffs from the British Virgin Islands and Netherlands Antilles against a Bermudan auditor). Moreover, excepting Mr. Davis' derivative claims pled in the alternative, Plaintiffs' claims have nothing to do with the Funds' internal affairs; the Complaints primarily charge third parties, outside the Funds. Thus, the "internal affairs doctrine" is plainly inapplicable. *See First Nat'l City Bank v. Banco Para El Comercio Exterior de Cuba*, 462 U.S. 611, 621-22 (1983) (holding internal affairs doctrine inapplicable "where the rights of third parties external to the corporation are at issue"); *Edgar v. MITE Corp.*, 457 U.S. 624, 645 (1982) (the doctrine only applies to "matters peculiar to" a "corporation's internal affairs"); *see also Druck Corp. v. Macro Fund Ltd.*, *IIU*, 290 Fed. Appx. 441, 443 (2d Cir. 2008) (applying the law of the state of incorporation only after finding that the claims were owned by the company and thus derivative).

also Fraternity Fund, 376 F. Supp. 2d at 408-09; *Shearson Lehman Hutton*, *Inc. v. Wagoner*, 944 F.2d 114, 120 (2d Cir. 1991) (in the bankruptcy context, "[a] claim against a third party for defrauding a corporation with the cooperation of management accrues to creditors, not to the guilty corporation"); *Hirsch v. Arthur Andersen & Co.*, 72 F.3d 1085, 1093-95 (2d Cir. 1995) (applying *Wagoner* rule to Ponzi scheme).

"The availability of direct actions is further shown by the asymmetrical injury alleged[.]" *Anwar II*, 728 F. Supp. 2d at 402. Plaintiffs do not allege losses "corresponding" or "in direct proportion" to the overall diminishment of the Funds' assets.[46] Def. Br. at 22. Rather, "because some investors had redeemed and realized appreciation of their initial investments, the Funds as a whole did not lose the value of all the initial investments." *Anwar II*, 728 F. Supp. 2d at 402. At the pleading stage, this is "sufficient information to show that Plaintiffs suffered individual harm distinct from losses experienced by other investors," and thus that the claims alleged are direct. *Id.*

In any event, even if foreign law applied, Plaintiffs have standing under the laws of Cayman Islands and Ireland. *See* J. Ryan Decl. ¶¶ 28-35; Lowe Decl. ¶¶ 22-49. Contrary to the Defendants' assertion (Def. Br. at 22), Plaintiffs' claims do not "depend upon an injury to a company." *See* Lowe Decl. at ¶ 48 ("[i]n each case ... the facts pleaded are capable of giving rise to a cause of action belonging to the Plaintiffs as opposed to the Funds and loss and damage separate and distinct from that of the Funds"). Nor does Defendants' glossed-over rendition of the "reflective loss principle" undermine the claims alleged. *Compare* Def. Br. at 22-23, *with* Lowe Decl. at ¶¶ 28-49 (defendants "present[] an incomplete and over simplified summary of ... the nature and recoverability of reflective losses by shareholder ... and the principles that govern

[46] Moreover, even if "each shareholder suffered an alleged common injury in direct proportion to the number of shares owned," Def. Br. at 22, the Second Circuit has rejected "differentiated harm" as a threshold for direct shareholder actions. *See Strougo v. Bassini*, 282 F.3d 162, 171-72 (2d Cir. 2002).

such claims," "shareholder may sue ... even if the loss is a diminution in the value of the shareholding," "None of [Plaintiffs' claims] are based on causes of action that belong to the Fund[s]"); *see also* J. Ryan Decl. at ¶¶ 28-33 (the claims alleged are direct, not derivative). Moreover, because "the company ha[s] no cause of action" due to its susceptibility to *in pari delicto*, shareholders can bring claims even if their losses were reflective of the Funds' losses. Lowe Decl. at ¶¶ 39, 46. Thus, under the governing law of New York, Cayman Islands, and Ireland, Plaintiffs have standing just the same.

VIII. THE NON-FUND DEFENDANTS' DUTIES ARE MANIFEST

The Complaints allege a variety of claims, including, *inter alia*, negligence, gross negligence, and breach of fiduciary duty, which are predicated on duties of care that the so-called "Non-Fund Defendants" owed to Plaintiffs. *See*, *e.g.*, HC ¶¶ 7, 53, 534, 713-19, 727-34, 736-46, 748-55, 758-65; PC ¶¶ 13, 202-13, 214-22, 223-31, 259-66, 279-85; TC ¶¶ 157-368. Under New York law,[47] as prescribed in *Credit Alliance Corp.*, these duties arise from allegations of: (1) an awareness by the defendant of a particular purpose for which a known party is relying; (2) reliance by a known party in furtherance of that purpose; and (3) some conduct by the defendant evincing its understanding of that reliance. 483 N.E.2d at 118 (1985); *see also Anwar II*, 728 F. Supp. 2d at 432 (finding Madoff feeder fund service providers owed duties of care to fund investors); *Pension Comm.*, 446 F. Supp. 2d at 199 (finding hedge fund administrators and other service providers owed duties of care to hedge fund investors).

The first prong is uniformly satisfied because Plaintiffs have alleged the Non-Fund Defendants' awareness "of how the information provided by them would be used by prospective, as well as current, investors, " *i.e.*, "that their involvement in the Funds lent significant credibility to the Funds, and provided potential [and] current investors with assurance about the

[47] New York law governs Plaintiffs' common law claims. *See* Section IV.A.I. *supra*.

quality of financial services provided to the Funds, the security of assets held by the Funds, and the accuracy of the reported values of the Funds and of the investors' individual accounts." *Anwar II*, 728 F. Supp. 2d at 433; *Am. Mfrs. Mut. Ins. Co. v. Payton Lane Nursing Home*, *Inc.*, No. CV-05-5155(SJF), 2007 WL 674691, at *6 (E.D.N.Y. Feb. 28, 2007); *see also* HC ¶¶ 7, 53, 534, 713-19, 727-34, 736-46, 748-55, 758-65; PC ¶¶ 13, 202-13, 214-22, 223-31, 259-66, 279-85; TC ¶¶ 245, 506. The second prong is satisfied because Plaintiffs have alleged that the Non-Fund Defendants' professional assurances, purported monitoring, and other custodial and advisory services were aimed at "a discrete group of potential investors." *Anwar II*, 728 F. Supp. 2d at 434; *AUSA Life Ins. Co. v. Ernst & Young*, 206 F.3d 202, 223 (2d Cir. 2000) (finding that plaintiffs established the known-party requirement as to prospective investors); *Fraternity Fund*, 376 F. Supp. 2d at 411 ("first-time investors" justifiably relied on defendant fund managers and principals "to publish accurate information about the Funds they managed"); *see also* HC ¶¶ 7, 53, 534, 713-19, 727-34, 736-46, 748-55, 758-65; PC ¶¶ 13, 202-13, 214-22, 223-31, 259-66, 279-85; TC ¶¶ 410, 506, 513. And the third prong is satisfied because Plaintiffs have alleged that the Non-Fund Defendants had reason to believe that information prepared by them would be disseminated by others to prospective investors. *Ossining Union Free Sch. Dist. v. Anderson*, 539 N.E.2d 91, 95 (N.Y. 1989) ("linking conduct" is "some conduct by the defendants … evincing defendant's understanding of their reliance"); *Pension Comm.*, 592 F. Supp. 2d at 641 ("sufficient to establish a 'linking' to plaintiffs such that it would have understood plaintiffs' reliance on these statements"); *Pension Comm. of the Univ. of Montreal Pension Plan v. Banc of Am. Sec.*, *LLC*, 617 F. Supp. 2d 216, 221 (S.D.N.Y. 2009) (transmission of portfolio statements to "interested parties" sufficient to satisfy linking requirement); *Gutman v. Equidyne Extractive Indus. 1980 Petro/Coal Program I*, No. 86 Civ. 9173(KID), 1990 WL 113193, at *5 (S.D.N.Y. July 27, 1990) (finding linking requirement satisfied because "it was foreseeable, and in fact

intended, that [the plaintiff], and all prospective investors, would review the Offering Memorandum and tax opinion letter and, as intended third-party viewers of the documents, rely on them for investment purposes"); *see also* HC ¶¶ 7, 53, 521, 534, 571, 579-87, 713-19, 727-34, 736-46, 748-55, 758-65; PC ¶¶ 13, 63-73, 202-13, 214-22, 223-31, 259-66, 279-85; TC ¶¶ 245, 410, 506, 513.

Thus, the predicate duties are manifest.

IX. DEFENDANTS' REMAINING DEFENSES FAIL

A. Madoff's Criminal Acts Were Not a Supervening Cause Immunizing Defendants From Liability

It is true that Bernard Madoff, through BLMIS, committed substantial violations of United States and New York criminal laws and, as a result, was sentenced to 150 years in prison. *See* HC ¶ 6; PC ¶ 1; TC ¶ 5. However, contrary to Defendants' assertions, *see* Def. Br. at 27-28, Madoff's criminal acts were not a supervening cause of Defendants' alleged violations of civil law, and Defendants may be held liable as alleged in Plaintiffs' Complaints. Indeed, Defendants did not merely "fail[] to prevent [an] intentional criminal act," but actually participated in and benefited from Madoff's crimes. *See*, *e.g.*, HC ¶¶ 2, 66, 197-207, 222, 240-41, 328-29; PC ¶¶ 3, 6, 8, 20, 73, 76, 81, 84, 88, 95, 109, 149, 154; TC ¶¶ 11, 16, 19, 50, 52, 154, 156, 302-05, 320.

Defendants may be held civilly liable despite the existence of Madoff's criminal acts if those alleged intervening acts were reasonably foreseeable. *See Dediarian v. Felix Contracting Corp*., 414 N.E.2d 666, 668-71 (N.Y. 1980). As alleged in Plaintiffs' Complaints, in light of the red flags and/or Defendants' failure to take appropriate actions in response, Madoff's Ponzi scheme was entirely foreseeable by Defendants. However, "[w]hether or not Madoff's actions were reasonably foreseeable is a question of fact not proper for resolution at the motion to dismiss stage." *Anwar II*, 728 F. Supp. 2d at 446 (*citing McCarthy v. Sturm*, *Ruger*, *& Co*., 916 F. Supp. 366, 372 (S.D.N.Y. 1996) ("whether an intervening act severs the chain of causation

depends on the forseeability of the intervening act and should be determined by the finder of fact")); *see also Emergent Capital Inv. Mgmt., LLC v. Stonepath Group, Inc.*, 343 F.3d 189, 197 (2d Cir. 2003) (any forseeability inquiry is "a matter of proof at trial and not to be decided on a Rule 12(b)(6) motion to dismiss").

Defendants' cases are inapposite. A wife's suicide, after stealing her police officer husband's gun and shooting him, is certainly an intervening intentional act prohibiting a finding that the husband was liable for the wife's death. *See Van Valkenburgh v. Robinson*, 639 N.Y.S.2d 149, 150 (N.Y. App. Div. 1966). This is not a case, moreover, where Plaintiffs recklessly dove off a beam into three feet of water resulting in their paraplegia. *Caraballo v. United States*, 830 F.2d 19, 20-22 (2d Cir. 1987) (cited in Def. Br. at 28). In this case it was Defendants, not Plaintiffs, who were reckless in ignoring bright red indications of Madoff's fraud. It was Defendants who dove, headfirst, into shallow water with Plaintiffs' money.[48]

B. Plaintiffs' Non-Fraud Claims Are Not Barred By Exculpation Provisions

"Documents outside a complaint may be considered only if it is 'clear that there exist[s] no material disputed issues of fact regarding the relevance of the document[s].'" *Anwar v.*

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[48] Defendants' citation to two cases which "each dismiss[ed] claims where Madoff's theft caused [the] plaintiffs' alleged losses" is also misplaced. Def. Br. at 28. In *Goldweber v. Harmony Partners, Ltd.*, No. 09-61902-CIV, 2011 U.S. Dist. LEXIS 26429 (S.D. Fla. Sept. 15, 2011), the court specifically "note[d] that Defendants are correct that this action is not similar to those actions against Madoff feeder funds because Defendants clearly disclosed in the [Private Placement Memorandum] that they were not fund managers, had no investment management experience, and were going to select a broker and turn over all investment decisions to the broker." *Id.* at *6-7 (emphasis in original) ("this case is fundamentally different from the numerous actions against Madoff feeder funds, wherein class or derivative actions were filed against experienced and investor-savvy fund managers who ignored the red flags of the Madoff firm's unfailing success"). Further, *Michael S. Rulle Family Dynasty Trust v. AGL Life Assurance Co.*, No. 10-231, 2010 U.S. Dist. LEXIS 67986 (E.D. Pa. July. 7, 2010), is inapplicable because in that action the defendant named as the fund manager had no responsibility for investment decisions. *Id.* at *19-20; *see also Michael S. Rulle Family Dynasty Trust v. AGL Life Assurance Co.*, No. 10-231, 2010 U.S. Dist. LEXIS 93955, at *8-9 (E.D. Pa. Sept. 9, 2010) (the defendant "AGL did not maintain exclusive control over the investment decisions"), *aff'd*, 2011 U.S. App. LEXIS 16687 (3rd Cir. Aug. 11, 2011).

Fairfield Greenwich Ltd., 745 F. Supp. 2d 360 (S.D.N.Y. 2010) (citing *Faulkner v. Beer*, 463 F.3d 130, 134 (2d Cir. 2006)). From Defendants' memorandum and experts' declarations, it is evident that, at a minimum, material disputed issues of fact exist as to whether the Herald (USA) and Primeo Funds' Articles of Association and Advisory Agreements and Offering Memoranda include exculpation clauses.

Defendants' experts do not even cite to the same documents and/or language to support their arguments that Plaintiffs' claims for non-fraudulent activity are barred as a matter of law.[49] On this subject Defendants cite to and proffer two experts, William James Bagnall ("Bagnall"), a partner in a Cayman law firm retained by UniCredit, PGAM, PAI, the Primeo Directors and defendant Saleta, and André Prüm ("Prüm"), a law professor at the University of Luxembourg retained by the HSBC Defendants. *See* Bagnall Decl. at ¶ 2 ; Prüm Decl. at ¶¶ 1, 4.

Bagnall cites to Herald (USA) and Primeo indemnity clauses to claim that Defendants are exculpated from liability to Plaintiffs. *See*, *e.g.*, Bagnall Decl. ¶ 46. On their faces, however, these clauses are not exculpation clauses and cannot be read to stand for the proposition that Defendants cannot be held liable for, *inter alia*, negligence and/or breaches of fiduciary duty. Instead, these clauses simply state that the Funds will indemnify their directors for any acts performed in their capacity as directors – not that the directors cannot be held liable to Plaintiffs. For example, Bagnall cites the following language in the Herald (USA) Fund's articles of association:

> In accordance with the Articles of Association of the Company, the Fund has indemnified each of the Directors from and against any and all actions, proceedings, damages, losses, charges, costs or expenses, suffered incurred or sustained by the Directors directly or indirectly as a result of their acting as Directors of the Fund and otherwise than as a result of the willful neglect or default of the Directors or by failing to act honestly and in good faith.

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[49] Defendants only produced purported exculpation clauses for the Herald (USA) and Primeo Funds.

See id. at ¶ 46. Contrary to Bagnall's and Defendants' contentions, this language only states that if the Herald (USA) Fund directors fail to perform their duties, *inter alia*, in good faith, the Fund will pay for any damage – it does not mean that the directors cannot be held liable for any damage resulting from their work as directors. Bagnall's blanket, conclusory statement that this language somehow implies exculpation holds no weight.

Bagnall proffers similar language from the relevant Primeo documents, but also states that "no such Director or officer shall be liable to the Company for any loss or damage in carrying out his functions unless that liability arises through actual fraud or willful default of such Director or officer." *See* Bagnall Decl. ¶ 46 (citing Primeo Articles of Association Article 201). First, this language says nothing about Defendants' liability to shareholders – only that the Primeo Director Defendants supposedly cannot be held liable to the Primeo Funds. Second, the language only purports to protect Primeo directors or officers and no other defendant – *i.e.*, not the Funds, UniCredit, PGAM and/or PAI. Third, the language only purports to protect Primeo directors or officers who "carry[] out [their] functions" as directors. In this action Plaintiffs contend that none of the directors or officers carried out their job functions – instead they ceded all authority to Madoff. Perhaps if the Primeo directors had actually functioned as directors, this clause might have some applicability, but as alleged in the Primeo Complaint, the Primeo directors did nothing. Accordingly, the language Bagnall cites is unavailing.

Prüm cites the Primeo and Herald SPC Offering Memoranda's descriptions of the limited roles of the Funds' administrators and custodians and investors' assumption of the risks of investing in those Funds. *See* Prüm Decl. at ¶¶ 59-60. The language Prüm cites, however, is wholly inapplicable to the issue of Defendants' exculpation from liability to Plaintiffs. At most, it stands for the unremarkable notion that the Funds' losses are borne by the Funds' shareholders – hardly surprising, and obviously the premise of this lawsuit. In any event, such language only

purports to protect the Herald (USA) and Primeo Funds' administrators and custodians – and no other defendant.

Thus Defendants' reliance on purported exculpation provisions is misplaced.

C. The Primeo and Herald Plaintiffs Have Standing to Sue BA

BA argues that Dr. Cabilly and Repex have no standing to sue it because BA Worldwide, one of its subsidiaries, ceased serving as investment advisor to the Primeo Funds on April 25, 2007, before Dr. Cabilly and Repex purchased their shares in the Primeo and Herald Funds. Velie Decl. ¶¶ 3-4. Dr. Cabilly and Repex do not sue BA solely in its capacity as the parent of BA Worldwide, however. As Plaintiffs allege, BA worked with Kohn to create the Primeo Funds, PC ¶¶ 22, 77; owned the trademark to the Primeo Funds, PC ¶ 77; met with Kohn and Madoff at his offices in New York two to three times a year for fifteen years to discuss how best to market the Primeo Funds, PC ¶¶ 78, 79; worked with Kohn to create Bank Medici – which operated as "Branch 1199" of BA and was staffed by BA – as a mechanism to solicit investors in the Primeo Funds, PC ¶¶ 82-83; and was unjustly enriched, throughout the class period, by both its 25% ownership of Bank Medici (which received $62 million from Madoff and BLMIS in 2007-2008 alone) and its direct receipt of fees totaling some $31 million, PC ¶ 84; *see also* HC ¶¶ 191, 216, 239-63, 269-70, 276, 298-309. Plaintiffs have sufficiently particularized the conduct of BA which had a "determinative or coercive effect" upon those who caused Plaintiffs' injuries even if it was not "the very last step in the chain of causation." *Bennett v. Spear*, 520 U.S. 154, 169 (1997) (cited at Velie Decl. 3 n.3).

D. The Herald Lux Liquidators Cannot Intervene In This Action

The Liquidators make three related arguments. The Liquidators first claim they are authorized under Luxembourg law to act on behalf of defendant Herald Lux. From this vantage point, they argue that the Herald Lux portion of the case should be stayed under Luxembourg

law and that only the Liquidators have the authority to bring claims on behalf of Herald Lux investors. Each of the Liquidators' arguments should be rejected, however, as they have no right to appear in this action. *Reserve Int'l Liquidity Fund*, *Ltd. v. Caxton Int'l Ltd.*, No. 09 Civ. 9021(PGG), 2010 U.S. Dist. LEXIS 42216, at *18 (S.D.N.Y. Apr. 29, 2010) ("before the Liquidators can appear in this action, seek a stay, or intervene on behalf of the Fund, they must obtain recognition under Chapter 15").

Chapter 15 of the Bankruptcy Code was enacted in 2005 "to provide effective mechanisms for dealing with cases of cross-border insolvency." *Id.* at *18 (citing 11 U.S.C. § 1501(a)(1)-(5)). Before a foreign bankruptcy proceeding can be recognized in a U.S. court, its foreign representative must petition the court and apply for recognition of the foreign proceeding. 11 U.S.C. § 1517. Only after recognition is granted can "the foreign representative [] apply directly to the court in the United States for appropriate relief in that court." 11 U.S.C. § 1509 (b)(2)-(b)(3); *see also Orchard Enter. NY*, *Inc. v. Megabop Records Ltd.*, No. 09 Civ. 9607(GBD), 2011 U.S. Dist. LEXIS 22896, at *6 (S.D.N.Y. Mar. 4, 2011) (granting default judgment where liquidator failed to formally apply for recognition under Chapter 15); *United States v. J.A. Jones Constr. Grp.*, *LLC*, 333 B.R. 637, 639 (Bankr. E.D.N.Y. 2005) (holding under Chapter 15, foreign representatives must be recognized in order to seek a stay from a federal court).

As the Liquidators have never petitioned the U.S. Bankruptcy Court for recognition, they may not appear on behalf of Herald Lux. *Reserve Int'l*, 2010 U.S. Dist. LEXIS 42216, at *18. A petition must include:

> (1) a certified copy of the decision commencing such foreign proceeding and appointing the foreign representative;
> (2) a certificate from the foreign court affirming the existence of such foreign proceeding and of the appointment of the foreign representative; or

> (3) in the absence of evidence referred to in paragraphs (1) and (2), any evidence acceptable to the court of the existence of such foreign proceedings and of the appointment of the foreign representative.

11 U.S.C. § 1515 (b). Additionally, a petition for recognition must include a statement "identifying all foreign proceedings with respect to the debtor that are known to the foreign representative." 11 U.S.C. § 1515 (c).

"Congress intended for these requirements to be strictly construed." *Orchard Enter.*, 2011 U.S. Dist. LEXIS 22896, at *7. "The House Report states that 'chapter 15 is intended to be the exclusive door to ancillary assistance to foreign proceedings' and that '[t]he goal [of Section 1509] is to concentrate control of these questions in one court. That goal is important in a Federal system like that of the United States with many different courts, state and federal, that may have pending actions involving the debtor or the debtor's property." *Reserve Int'l*, 2010 U.S. Dist. LEXIS 42216, at *17 (quoting H.R. Rep. No. 109-31, at 110-11 (2005)). The House Report goes on to note that under prior law, some courts had:

> granted comity suspension or dismissal of cases involving foreign proceedings without requiring a [] petition or even referring to the requirements of that section. Even if the result is correct in a particular case, the procedure is undesirable, because there is room for abuse of comity. Parties would be free to avoid the requirements of this chapter and the expert scrutiny of the bankruptcy court by applying directly to a state or Federal court unfamiliar with the statutory requirements.

Id. at *17-18.

Here, the Liquidators failed to satisfy the strict statutory requirements for recognition under Chapter 15. The Liquidators have not attempted to obtain Chapter 15 recognition of any pending Luxembourg proceedings. The Liquidators did not formally petition any court for recognition under Chapter 15. Even if the Liquidators claim its filings before this Court are "a petition to the court for recognition, it falls far below the statutory requirements and the legislative intent of Chapter 15." *Orchard Enter.*, 2011 U.S. Dist. LEXIS 22896, at *8-9. The

filing "makes no reference to Chapter 15 statutory requirements. It does not request that the [] Liquidators be recognized as foreign representatives. It does not provide a summary of the [] foreign proceedings. It is also filed in this Court and not before the Bankruptcy Court." *Id.* at *9 (citing *J.A. Jones*, 333 B.R. at 638 ("relief under Chapter 15 is available only after a foreign representative commences an ancillary proceeding for recognition of a foreign proceeding before the bankruptcy court")). Because the filing "does not comport with the strict statutory requirements of Chapter 15," the Liquidators lack standing to appear on behalf of defendant Herald Lux and cannot be considered a party to this litigation. *Id.*

X. THE HERALD PLAINTIFFS ADEQUATELY PLEAD VIOLATIONS OF RICO

A. The PSLRA's RICO Amendment Does Not Apply to Plaintiffs' Foreign Transactions

As discussed *supra* at Section VI.A.1, because Plaintiffs have not made a "purchase or sale … in the United States" or a purchase or sale of "a security listed on a domestic exchange[,]" U.S. securities laws do not apply. *Morrison*, 130 S. Ct. at 2886. Among the laws which do not apply are the PSLRA and its RICO Amendment. The RICO Amendment applies only to "conduct that would have been actionable as fraud in the purchase or sale of securities…." *MLSMK Inv. Co. v. JP Morgan Chase & Co.*, No. 10-3040-cv, 2011 U.S. App. LEXIS 13822, at *16 (2d Cir. July 7, 2011) (quoting 18 U.S.C. § 1964(c)); *see also Automated Teller Mach. Advantage LLC v. Moore,* No. 08 Civ. 3340(RMB)(FM), 2009 U.S. Dist. LEXIS 68724, at *11 (S.D.N.Y. Aug. 6, 2009) (Berman, J.). Post-*Morrison*, plaintiffs do not allege any conduct that is "actionable as fraud" because U.S. securities laws do not apply to Plaintiffs' overseas transactions. 130 S. Ct. at 2878.

Indeed, Plaintiffs' investments do not even meet the post-*Morrison* definition of "securities" under U.S. securities laws. A threshold issue for determining whether the RICO Amendment applies is "whether the scheme involved 'securities,' as that term is defined by the

Securities Act of 1933 [and] the Securities and Exchange Act of 1934." *Automated Teller*, 2009 U.S. Dist. LEXIS 68724, at *11. The Supreme Court in *Morrison* examined both the '33 and '34 Acts, and determined that the term "securities" includes only "securities listed on domestic exchanges" or unlisted securities bought or sold in "domestic transactions." 130 S. Ct. at 2884. As Plaintiffs have not purchased any "securities" as that term has been defined in *Morrison*, the RICO Amendment cannot protect Defendants.[50]

B. The Madoff-Kohn Enterprise is Located in this District

Defendants argue, alternatively, that Plaintiffs' RICO claims should be dismissed because the conduct alleged to have violated RICO is exterritorial. Def. Br. at 41-42. Defendants are wrong.

The Madoff-Kohn Enterprise is a domestic enterprise. As such, RICO applies. *See In re Le-Nature's, Inc. v. Krones, Inc.*, No. 09-1445, 2011 U.S. Dist. LEXIS 56682, at *18 (W.D. Pa. May 26, 2011) (holding that "the principles of Morrison do not bar a RICO claim if a complaint avers a domestic enterprise"). The fact that some members of the Madoff-Kohn Enterprise are located overseas is irrelevant. *See, e.g., United States v. Marzook*, 426 F. Supp. 2d 820, 826 (N.D. Ill. 2006) (foreign entity liable under RICO).

In *European Community v. RJR Nabisco, Inc.*, No. 2-5771(NGG)(VVP), 2011 U.S. Dist. LEXIS 23538, at *17-21 (E.D.N.Y. Mar. 8, 2011), the court used the Supreme Court's "nerve center test," from *Hertz Corp. v. Friend*, 130 S. Ct. 1181 (2010), to determine the location of the RICO enterprise. *Hertz* concluded "that [a corporation's] 'principal place of business' is … the place where a corporation's officers direct, control, and coordinate the corporation's activities. It

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[50] Defendants may argue that the Second Circuit's recent decision in *MLSMK Inv. Co. v. JP Morgan Chase & Co.*, No. 10-3040-cv, 2011 U.S. App. LEXIS 13822 (2d Cir. July 7, 2011), ruled the PSLRA's RICO Amendment prohibits Plaintiffs from alleging RICO violations. However, *MLSMK Inv. Co.* did not address whether the RICO Amendment applied to extraterritorial transactions.

is … called the corporation's 'nerve center.'" 130 S. Ct. at 1192.

Defendants argue that the RICO claims should be dismissed because the claims involve "foreign parties who allegedly recruited foreign investors to invest in foreign funds[.]" *See* Def. Br. at 42. However, those facts do not show where the "nerve center" of the Madoff-Kohn Enterprise is located. Instead, the very same facts showing that the Court has personal jurisdiction over the Personal Jurisdiction Defendants, at Section III.A., *supra*, also show that New York was the nerve center of the Enterprise. Defendants have not argued otherwise, much less proposed a different location for the enterprise's nerve center. Thus, Defendants have not met their burden to show that the Madoff-Kohn Enterprise is located anywhere but New York.

C. The RICO Defendants Caused Plaintiffs' Injuries

Defendants argue that they are not liable under RICO. Def. Br. at 42-45. This argument ignores the allegations of the Herald Complaint. The Madoff-Kohn Enterprise began functioning in 1993. HC ¶ 229. It was at this time that Madoff and S. Kohn, through Eurovaleur, conspired with Bank Austria, Randa, Zapotocky, Scheithauer, Nograsek, and Duregger to create the Primeo Fund. HC ¶¶ 228-29, 232. Kohn, Bank Austria, and others conspired to market the Primeo Fund while concealing the fact that Madoff and BLMIS would act as both investment manager and *de facto* custodian. HC ¶ 231. Bank Austria generated misleading Primeo marketing materials. *Id.* Throughout the majority of its existence, unbeknownst to investors, Primeo Fund was 100% invested through BLMIS. HC ¶¶ 231, 233.

Bank Austria incorporated its subsidiary BA Worldwide to be the "investment manager" of the Primeo Fund. HC ¶ 237-38. BA Worldwide also claimed to be the investment adviser to the Thema Fund and Alpha Prime Fund. HC ¶ 241. BA Worldwide was the investment adviser to the Primeo Fund from 1993 until 2007, until PGAM took over this role at UniCredit's direction. HC ¶ 239. BA Worldwide existed only to service the Medici Enterprise Feeder

Funds. *Id.*

BA Worldwide received fees of at least $55 million for its participation in the Madoff Feeder Fund Scheme. HC ¶ 240. Bank Austria directed BA Worldwide to pay Kohn, through Eurovaleur, over $11 million over a span of 10 years, in 98 instances of laundering of monetary instruments and monetary transactions in criminally derived property in violation of 18 U.S.C. §§ 1956 and 1957. HC ¶¶ 401-02. Herald (USA) investors were directed by the Fund to send checks or wire transfers of funds from overseas locations into banks located in this District. Each of these international transfers were either instances of mail fraud under 18 U.S.C. § 1341 in furtherance of the Illegal Scheme or instances of wire fraud under 18 U.S.C. § 1343 in furtherance of the Illegal Scheme. HC ¶ 637. These transfers numbered in the thousands. *Id.* Bank Austria's account received fictitious profits from BLMIS in the amount of $249,627.82. HC ¶ 245. Bank Austria received one wire transfer and two checks via U.S. mail consisting of stolen funds from BLMIS over the life of its direct account. *Id.*

Kohn and Bank Austria also created Bank Medici. HC ¶¶ 247-48. Bank Austria operated Bank Medici as a *de facto* "branch" and referred to it internally as "Branch 1199." HC ¶ 249. Bank Medici and Bank Austria had a "revolving door" of officers, directors, and employees. HC ¶ 250. This mutual Kohn/Bank Austria ownership and operating structure continued after UniCredit purchased Bank Austria. *Id.*

Bank Austria, for its various roles in the Madoff Feeder Fund Scheme, received at least $31 million, not including the fictitious profits it took from its direct account at BLMIS. HC ¶ 194. Bank Medici existed only to solicit money for BLMIS, for which Madoff secretly paid S. Kohn through her Kohn's New York Sham Businesses. HC ¶ 196. Bank Medici itself received over $62 million for its role in the scheme. *Id.*

These facts show Defendants deliberately engaged in the Illegal Scheme and Plaintiffs

have abundantly pled their scienter. Plaintiffs have alleged facts: (i) showing that Defendants had both motive and opportunity; or (ii) constituting circumstantial evidence of conscious behavior or recklessness. *See Powers v. British Vita, P.L.C.*, 57 F.3d 176, 184-85 (2d Cir. 1995). The appropriate inquiry is "whether *all* of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard." *Pollio v. MF Global, Ltd.,* 608 F. Supp. 2d 564, 572 (S.D.N.Y. 2009) (emphasis in original). Here, Plaintiffs have met both of these tests.[51]

Defendants rely largely on *Lerner v. Fleet Bank, N.A.* for the proposition that RICO's "directness" test is not satisfied where the alleged misconduct served to aid and abet a Ponzi scheme perpetrated by a third party. 318 F.3d 113, 118-19, 123-24 (2d Cir. 2003). However, unlike in *Lerner,* Defendants here were primary actors in their own scheme that directly injured Plaintiffs. Defendants' misconduct need only be a direct cause, not the sole cause, of Plaintiffs' injuries to satisfy the directness standard. *See In re Refco Inc. Sec. Litig.*, Nos. 07-md-1902(JSR), 08-cv-7416(JSR), 2010 WL 6397586, at *43 (S.D.N.Y. July 19, 2010). Nor is it necessary for Plaintiffs to show Defendants intended Plaintiffs' injury. *See Hemi Grp., LLC v. City of New York,* 130 S. Ct. 983, 991 (2010). Rather, Plaintiffs need only show that Defendants created a "risk of harm." *Baisch v. Gallina*, 346 F.3d 366, 376 (2d Cir. 2003).

D. The Herald Complaint States a Claim Under Section 1962(c)

To allege an association-in-fact RICO enterprise, Plaintiffs "must plead the existence of a group of individuals or other legal entities with '[i] a purpose, [ii] relationships among those associated with the enterprise, and [iii] longevity sufficient to permit these associates to pursue the enterprise's purpose.'" *Automated Teller*, 2009 U.S. Dist. LEXIS 68724, at *19 (citing *Boyle*

[51] The pleading requirements of Rule 9(b) are relaxed with respect to pleading the scienter element of mail and wire fraud under civil RICO. *See O'Brien v. Nat'l Prop. Analyst Partners*, 936 F.2d 674, 676 (2d Cir. 1991).

v. United States, 129 S. Ct. 2237, 2244 (2009)). The facts above show that this standard has been met.

Furthermore, the Herald Complaint shows Defendants had operational control and management of the Enterprise. The operation or management test is a relatively low hurdle for plaintiffs to clear at the pleading stage. *Automated Teller,* 2009 U.S. Dist. LEXIS 68724, at *21. Every Defendant need not be the "mastermind" of the Illegal Scheme. Liability under § 1962(c) is "not limited to upper management …. [a]n enterprise is 'operated' not just by upper management but also by lower rung participants in the enterprise …." *Reves v. Ernst & Young,* 507 U.S. 170, 184 (1993).[52]

The facts also show Defendants engaged in a continuous pattern of racketeering throughout the course of the Illegal Scheme. The Madoff-Kohn Enterprise's many members, over at least 10 years, engaged in unlawful conduct. Defendants' hundreds of predicate acts,[53] deeply intertwined participants, and the longevity of their racketeering activity satisfy both the closed-ended and open-ended continuity requirements.[54]

E. The Herald Complaint States a Claim Under Section 1962(d)

Defendants conspired with each other to engage in a pattern of racketeering activity in violation of 18 U.S.C. § 1962(d). Defendants contend Plaintiffs cannot plead conspiracy because

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[52] "Aggressor" corporations like UniCredit, Herald, and Bank Austria, who are "active perpetrator[s] of the fraud," are liable for the acts of their employees and officers and directors under RICO. *USA Certified Merchs., LLC v. Koebel,* 262 F. Supp. 2d 319, 328 (S.D.N.Y. 2003). UniCredit, Herald, and Bank Austria may also be held liable for the actions of their subsidiaries and executives under theories of agency. *See*, *e.g.*, *id.*

[53] The RICO Statement from *Picard v. Kohn*, Adv. Pro. No. 10-05411 (BRL) (Bankr. S.D.N.Y. Dec. 10, 2010), attached as Bunch Decl. Ex. B, shows hundreds of additional predicate acts.

[54] The Madoff-Kohn Enterprise presents the threat of continued unlawful activity which satisfies open-ended continuity. *See Fresh Meadow Food Servs. LLC v. RB 175 Corp.*, 282 Fed. Appx. 94, 99 (2d Cir. 2008). Although the Ponzi scheme ended with Madoff's confession, the Illegal Scheme is ongoing, as the Madoff-Kohn Enterprise continues to launder its ill-gotten gains by moving funds and concealing ownership. *See, e.g.*, HC ¶¶ 328, 428-29.

UniCredit and Bank Austria are not liable for RICO and because Plaintiffs have not alleged a "conscious agreement" to engage in the Illegal Scheme. *See* Def. Br. at 44-45. Despite the "secrecy and concealment" of the Illegal Scheme, however, Plaintiffs plead ample facts to state a conspiracy claim against each Madoff-Kohn Enterprise Defendant. *Madanes v. Madanes*, 981 F. Supp. 241, 259 (S.D.N.Y. 1997) (participation in the conspiracy can be shown entirely through circumstantial evidence); *United States v. Cassino*, 467 F.2d 610, 618 (2d Cir. 1972) ("[y]our common sense will tell you that when men in fact undertake to enter into a criminal conspiracy, much is left to the unexpressed understanding").

Under 18 U.S.C. § 1962(d), Plaintiffs have established that each Defendant agreed "to conduct the affairs of a particular, identified enterprise through a pattern of racketeering activity." *Elsevier, Inc. v. W.H.P.R., Inc.,* 692 F. Supp. 2d 297, 313 (S.D.N.Y. 2010).[55]

CONCLUSION

For the foregoing additional reasons,[56] Plaintiffs respectfully request that the Court grant Plaintiffs' motion for leave to amend and deny Defendants' motion to dismiss.

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[55] There is neither a requirement that the defendant committed some overt act nor is there a rule that a "conspirator knew of all criminal acts by insiders in furtherance of the conspiracy." *United States v. Zichettello*, 208 F.3d 72, 100 (2d Cir. 2000).

[56] For the reasons outlined in Plaintiffs' motion to amend, leave to amend is appropriate under Fed. R. Civ. P. 15(a)(2) and should be granted. As demonstrated by the redlined versions of the Complaints attached to the Declaration of Albert Y. Chang on that motion, substantial new evidence became available to Plaintiffs between September 10, 2010, the date Plaintiffs each filed their initial complaints [*see* Dkt. Nos. 74-76], and April 1, 2011, the date Plaintiffs moved to amend. Even since April 1, 2011, substantial new evidence has become available to Plaintiffs through public disclosure of redacted information concerning several of the Defendants and in the Declaration of Timothy S. Pfeifer in Support of the Trustee's Opposition to the Motions to Dismiss, Ex. 1 in *Picard v. Kohn,* No. 11-cv-01181 (S.D.N.Y. Aug. 29, 2011) (Proposed Second Amended Complaint, Dkt. No. 54-1). Bunch Decl. Ex. C. Notably, unlike the Trustee, Plaintiffs have not had any discovery in this action to date.

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Respectfully submitted,

COHEN MILSTEIN SELLERS & TOLL PLLC

/s/ S. Douglas Bunch

Steven J. Toll
Lisa M. Mezzetti
Daniel S. Sommers
Joshua S. Devore
S. Douglas Bunch (SB-3028)
1100 New York Avenue, N.W.
Suite 500, West Tower
Washington, D.C. 20005-3964
Telephone: (202) 408-4600
Facsimile: (202) 408-4699

Lead Counsel for Lead Plaintiff Dr. Shmuel Cabilly**, **Plaintiff Korea Exchange Bank**, **and the Class (Leonhardt action)

Jacob Sabo, Esq.
The Tower
#3 Daniel Frisch Street
Tel Aviv Israel
Telephone: (972) 360-78888
Facsimile: (972) 360-78889

Additional Counsel for Lead Plaintiff Dr. Shmuel Cabilly

STULL, STULL & BRODY
Jules Brody (JB-9151)
Patrick Slyne (PS-1765)
6 East 45th Street
New York, NY 10017
Telephone: (212) 687-7230
Facsimile: (212) 490-2022

STULL, STULL & BRODY
Timothy J. Burke (admitted *pro hac vice*)
10940 Wilshire Boulevard, Suite 2300
Los Angeles, CA 90024
Telephone: (310) 209-2468
Facsimile: (310) 209-2087

Lead Counsel for Lead Plaintiff Repex Ventures**,**
S.A.**,** ***Dana Trezziova*****,** ***and the Class (Repex action)***

CHAPIN FITZGERALD SULLIVAN & BOTTINI LLP
Francis A. Bottini, Jr. (admitted *pro hac vice*)
Albert Y. Chang (AC-5415)
501 West Broadway, Suite 1720
San Diego, CA 92101
Telephone: (619) 230-0063
Facsimile: (619) 238-0622

Lead Counsel for Lead Plaintiff Neville Seymour Davis and the Class (Perrone action)

MURRAY FRANK LLP
Brian P. Murray (BM-9954)
Gregory B. Linkh (GL-0477)
275 Madison Avenue, Suite 801
New York, NY 10016
Telephone: (212) 681-1818
Facsimile: (212) 682-1892

Additional Counsel for Lead Plaintiff Neville Seymour Davis

ROBBINS GELLER
RUDMAN & DOWD LLP
Darren J. Robbins
James I. Jaconette
David W. Hall
655 West Broadway, Suite 1900
San Diego, CA 92101
Telephone: (619) 231-1058
Facsimile: (619) 231-7423

- and -

Jack Reise
197 South Federal Highway, Suite 200
Boca Raton, FL 33432
Telephone: (561) 750-3000
Facsimile: (561) 750-3364

Counsel for Lead Plaintiff Neville Seymour Davis