To commence the statutory time period of appeals as of right (CPLR 5513[a]), you are advised to serve a copy of this order, with notice of entry, upon all parties.

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF WESTCHESTER
COMMERCIAL DIVISION

Present: HON. ALAN D. SCHEINKMAN,
Justice.

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EB BRANDS HOLDINGS, INC.

Plaintiff,

-against-

McGLADREY LLP, f/k/a McGLADREY & PULLEN, LLP,

Defendant.

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Index No. 64265/14
Motion Sequence No. 2
Motion Date: May 8, 2015

DECISION & ORDER

Scheinkman, J:

In this action sounding in professional malpractice, Defendant McGladrey LLP ("Defendant" or "McGladrey") moves, pursuant to CPLR 3211 (a) (1), (5), and (7) to dismiss the Complaint of Plaintiff EB Brands Holdings, Inc. ("Plaintiff" or "EB"). Plaintiff opposes the motion.

RELEVANT BACKGROUND

This is the second dismissal motion to come before this Court in this case. Previously, by Decision and Order entered January 2, 2015 (the "Stay Order"), this Court stayed this action pending the final determination of a prior action commenced by EB against McGladrey in Supreme Court, New York County.

EB is a consumer packaged goods company which is located in Elmsford, Westchester County, New York. McGladrey is a public accounting firm with offices in New York County. McGladrey performed audit work for EB for a number of years, ending in the 2011 fiscal year.

EB commenced the prior action against McGladrey in Supreme Court, New York County on December 17, 2013 (Index No. 654342/13) (the "New York County Action"). Plaintiff selected New York County as the venue based upon its assertion that McGladrey has an office in New York County and some of its partners reside in New York County. McGladrey moved to dismiss the Complaint in the New York County Action and filed a Request for Judicial Intervention, which led to the case being assigned to Hon. Jeffrey K. Oing, Supreme Court Justice, New York County, Commercial Division.

Rather than opposing McGladrey's motion, EB interposed an Amended Complaint. Once again, McGladrey moved to dismiss; a motion that was opposed by EB.

Justice Oing heard oral argument on the motion to dismiss the Amended Complaint on August 14, 2014. After a lengthy argument, Justice Oing proceeded to determine the motion by oral decision spread on the record. Justice Oing commenced the decision by announcing the result: "I am going to grant the motion to dismiss and dismiss the complaint," finding that "the allegations here are insufficient to plead a claim for professional malpractice, gross negligence, or breach of contract" (Affirmation of Veronica Rendón, dated April 1, 2015 ["Rendón Aff."] Ex. 8, Transcript ["NYTr."] at 86). The Court proceeded to explain the basis for its decision over the next 6 pages. At the end, the Court added a caveat to its decision: "Of course, the dismissal is without prejudice to the plaintiff's decision, if they are so advised to replead. And that's where we stand. So that's my decision and order" (*id.* at 92). Justice Oing directed that McGladrey's counsel, as the moving party, order the transcript and stated that he would "so order" the transcript (*id.*).

On August 14, 2014, Justice Oing signed an order which stated that "the motion [was] decided on the record, noted that the movant had been directed to order the transcript, and that the transcript would be 'so ordered.'" This order of August 14, 2014 [the "Dismissal Order"] was entered by the New York County Clerk on August 18, 2014.

Instead of filing a further amended Complaint, as was allowed by Justice Oing, EB commenced a new action in this Court (Supreme Court, Westchester County) on September 8, 2014. McGladrey then moved to dismiss on the grounds of prior action pending and *res judicata* and, alternatively, to change venue.

In the Stay Order, this Court determined that the New York County Action was still pending but, rather than dismiss this action as McGladrey requested, the Court stayed this action pending the final determination of the New York County Action. This Court found it unnecessary, in view of the stay, to reach the other issues that had been

raised by McGladrey.

EB then began efforts to extricate itself from the New York County litigation, which led to some considerable procedural wrangling.

EB submitted a proposed Judgment dismissing the New York County Action without prejudice. McGladrey objected to a dismissal without prejudice and requested that EB be ordered to submit a further amended complaint and argued that if EB failed to do so, then its case should be dismissed with prejudice. In subsequent correspondence to Justice Oing, counsel for McGladrey asserted that EB's proposed judgment was predicated upon 22 NYCRR 202.48, which applies where the court directs settlement of a judgment or order. She contended that EB could not just submit a judgment *sua sponte* but either had to (a) replead; or (b) consent to a final judgment of dismissal with prejudice based on its failure to replead; or (c) voluntarily discontinue the New York Action pursuant to CPLR 3217 (Rendón Aff., Ex. 17). In furtherance of its arguments, McGladrey submitted a proposed counter-judgment, to which EB objected.

Eventually, an Order and Judgment (one paper) (the "New York County Judgment") was entered on January 28, 2015 in the New York County Action. That document was based upon the form of judgment proposed by McGladrey but was modified by handwriting by Justice Oing (Rendón Aff., Ex. 19).

In the recitals leading up to the operative language, the Court acknowledged that EB had waived its right to replead or otherwise proceed in the New York County Action and that EB had waived its right to appeal from Justice Oing's order entered August 18, 2014 and any judgment entered thereon. The New York County Judgment then states:

> **NOW**, for the reasons stated in the Court's Order and the So-Ordered Transcript of the oral argument proceedings before the Honorable Jeffrey K. Oing on August 14, 2014, and because EB Brands <u>is deemed to have</u> elected to voluntarily discontinue the above-captioned action by waiving its right to replead and/or appeal <u>& considering the parties' proposed judgments</u>, it is hereby
>
> <u>ORDERED &</u> **ADJUDGED**, that the First Amended Complaint against McGladrey is hereby dismissed <u>without prejudice</u> (Rendón Aff., Ex. 19) (bold print in original) (underlined material reflects changes made to McGladrey's form of judgment by Justice Oing).

Thereafter, counsel for both parties entered into a Stipulation dated February 18, 2015 which this Court "so ordered" on February 19, 2015 and upon which this Court vacated the stay of this action, as requested therein by the parties (the "Stipulation"). The Stipulation states as follows:

> WHEREAS this Court issued a Decision & Order dated January 2, 2015 staying the above-captioned action because the lawsuit known as EB Brands Holdings, Inc. v McGladrey LLP, Index No. 654342/2013, in the Supreme Court of the State of New York, County of New York (the "New York Action") was still pending; and
>
> WHEREAS Justice Jeffrey K. Oing, for the reasons stated in the Court's Order dated August 14, 2014 and entered on August 18, 2014, **and because EB Brands is deemed to have elected to voluntarily discontinue the New York Action**, entered a final judgment of dismissal without prejudice in the New York Action on January 28, 2015;
>
> IT IS HEREBY STIPULATED AND AGREED by the parties hereto through their undersigned counsel that:
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> 1. Plaintiff EB Brands Holdings, Inc. ("EB Brands") waives any right it may have now, or in the future, to amend the Complaint filed on September 9, 2014 in this action (the "Complaint"), whether as of right or by leave of court, including without limitation pursuant to CPLR 3025(a) and (b), except that EB Brands may amend its complaint following the close of discovery pursuant to CPLR 3025(c) if and only if warranted by evidence revealed during the course of discovery and with leave of court. EB Brands additionally waives any right it may have, now or in the future, to bring any claims against McGladrey arising out of the same transactions and occurrences alleged in the Complaint in any other court;
>
> 2. Defendant McGladrey LLP ("McGladrey") waives its right to appeal the Judgment of Justice Jeffrey K. Oing in the New York Action; and
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> 3. The parties therefore, reserving all other rights, jointly

> request that the stay in this action be lifted (emphasis added).

Upon the lifting of the stay, the present motion was made and opposed.

THE CONTENTIONS OF THE PARTIES

In support of its motion, McGladrey submits an affirmation from its counsel to which various exhibits are annexed and a memorandum of law.

McGladrey contends that this action is barred by the statute of limitations since (a) it was commenced more than two years after the date of the last audit report – a period set by its engagement letter; and (b) while the New York County Action was timely commenced, this action is not saved by CPLR 205(a) since that provision does not apply to prior actions terminated by voluntary discontinuance. McGladrey argues that *res judicata* bars this action because EB has failed to rectify the deficiencies in its pleading that formed the basis for the New York County Action's dismissal. McGladrey also contends that, in any event, EB has failed to state a viable cause of action.

In opposition, EB submits an affirmation from its counsel to which several exhibits are annexed and a memorandum of law.

EB contends that McGladrey's motion to dismiss should not even be considered because it is a second CPLR 3211 motion and CPLR 3211(e) limits a responding party to just one such motion. EB asserts that the present action is timely since the New York County Action was brought with four months left on the limitations clock, the New York County Action stopped the clock, and since this action was filed while the clock was stopped, it is timely. EB argues that CPLR 205(a) applies because the New York County Judgment is not a voluntary discontinuance. EB maintains that it has corrected the deficiencies identified by Justice Oing, that McGladrey's engagement letter does not exculpate it from its own negligent acts, and that EB's pleading states viable causes of action.

McGladrey submits a reply memorandum which adheres to the arguments previously advanced and which contains an argument as to why McGladrey's motion does not run afoul of the "single motion" rule.

ANALYSIS

McGLADREY'S MOTION DOES NOT VIOLATE THE "SINGLE-MOTION RULE"

CPLR 3211(e) provides that, prior to the service of an answer, a defendant may move for dismissal upon one or more of the grounds set forth in CPLR 3211(a) "and no more than one such motion shall be permitted." Here, McGladrey previously moved for dismissal, obtaining only a stay, and EB now asserts that a second motion is precluded. The Court does not agree.

The purpose underlying the "single-motion rule" is to encourage the movant to present all of the potential arguments for dismissal in one submission, rather than piecemeal, as well as to avoid delay, to spare the court unnecessary burdens, and protect the pleader from harassment. Notwithstanding the seemingly absolute restriction to one dismissal motion per case, the courts have permitted a second dismissal motion where the purposes underlying the rule are not thwarted. For example, where the plaintiff interposes an amended complaint, a motion to dismiss may be made notwithstanding that the same defendant made a prior motion to dismiss the original complaint (*Sevenson Hotel Assoc., Inc. v Stranges*, 262 AD2d 957 [4th Dept 1999]; *see also Held v Kaufman*, 91 NY2d 425 [1998] ["single-motion rule" not violated where defendants raised additional arguments in reply papers and plaintiff had chance to respond to them]). But the "single-motion rule" does bar a second attempt to raise arguments previously decided on the merits on a prior motion to dismiss (*see, e.g., B.S.L. One Owners Corp. v Key Intl. Mfg., Inc.*, 225 AD2d 643 [2d Dept 1996]). Thus, the interposition of an amended complaint, which did not add any causes of action and simply restated and renumbered some pre-existing causes of action, did not give defendant the right to make a second motion for dismissal (*Swift v New York Med. College*, 48 AD3d 671 [2d Dept 2008]; *see also Ross v Epstein*, 26 AD2d 658 [2d Dept 1996]).

The "single-motion rule" does not apply where the prior motion was not decided on the merits (*Rivera v Board of Educ. of City of N.Y.*, 82 AD3d 614 [1st Dept 2011]). For example, where the original dismissal motion was held in abeyance pending the outcome of a different litigation, a later motion to dismiss was not precluded by the "single-motion rule" (*Curtis v Chetrit*, 243 AD2d 423 [1st Dept 1997], *lv dismissed* 92 NY2d 848 [1998]; *Chester Med. Diagnostic, P.C. v State Farm Mut. Auto. Ins. Co.*, 2009 NY Slip Op 52598[U], 26 Misc 3d 126[A] [Sup Ct, App Term 2nd, 11th & 13th Jud. Dist. 2009]; *accord, Breiterman v Haidt*, 2004 NY Slip Op 50683[U], 4 Misc 3d 130[A] [Sup Ct, App Term 1st Dept 2004]).

Here, the Court did not rule on the merits of that branch of the prior motion to dismiss which sought dismissal on the grounds of *res judicata*. Further, the final judgment entered in the New York County Action, which is material to the issue of *res judicata*, did not come into existence until after the Stay Order and its significance therefore could not have been addressed on the prior motion, in any event[1]. Likewise, the present statute of limitations argument could not have been raised while the New York County Action was pending as the New York County Action had been ruled timely, as against a different argument, by Justice Oing and the action was still pending when this Court issued the Stay Order[2]. The "single-motion rule" should not be read as to prevent a party from raising arguments based on later-arising facts, which arguments simply could not have been presented on the prior motion (*Barbarito v Zahavi*, 107 AD3d 416, 420 [1st Dept 2013]).

Here, this Court stayed this action pending the resolution of the New York County Action. Had EB elected to pursue its claims in New York County, it would not have been necessary to reach the merits of McGladrey's dismissal argument. Because EB elected to proceed here, it is appropriate for this Court to now reach the merits of the dismissal arguments.

Allowing McGladrey to raise the *res judicata* and statute of limitations arguments by this motion will avoid delay, not incur it, and will curtail costs, not add to them. These arguments could be addressed upon a post-answer motion for summary judgment (*see Ancrum v St. Barnabas Hosp.*, 301 AD2d 474 [1st Dept 2003]; *Tapps of Nassau Supermarkets, Inc. v Linden Blvd., L.P.*, 269 AD2d 306 [1st Dept 2000]). Little purpose would be served not to address the issues now; denying the motion and having McGladrey move for summary judgment will just lead to another round of motion practice with attendant delay and cost. Nor can it be said that McGladrey is harassing EB by repetitive motions. The present circumstance is due to EB having sued in New York County, having received a decision it did not agree with, and then electing to sue over again in Westchester, despite having the opportunity (which it declined) to replead in New York County and/or to appeal to the Appellate Division, First Department.

Additionally, addressing the issues of *res judicata* and statute of limitations at this time, which issues are quite meritorious, promotes judicial economy

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[1]At the time of McGladrey's original motion, no judgment had been entered in the New York County Action and the time to appeal had not elapsed, rendering the application of *res judicata* questionable in the absence of a final judgment.

[2]Justice Oing held that the New York County Action was timely based on the fact that it was brought within two years of completion of the last audit and was timely as to at least that audit. Justice Oing could not have ruled on the timeliness of this action.

by avoiding the necessity of having this Court supervise discovery with respect to the merits of an action, when the merits will never be reached.

Accordingly, the Court will address the merits of the dismissal arguments advanced by McGladrey.

THIS ACTION IS BARRED BY THE STATUTE OF LIMITATIONS

The most recent – and apparently last – engagement letter between EB and McGladrey, dated December 19, 2011 (Rendón Aff., Ex. 4) provides that no claim arising out of services rendered pursuant to the agreement may be filed more than two years after the audit report was issued by McGladrey. This agreement to shorten the otherwise applicable limitations period is permissible and enforceable (CPLR 201; *see generally Hunt v Raymour & Flanigan*, 105 AD3d 1005 [2d Dept 2013]).

There is no dispute over the fact that the audit report was issued May 4, 2012 (Rendón Aff., Ex. 4). This action was commenced on September 8, 2014.

EB argues that, even though this action was commenced more than two years after the audit report was issued, the action should be considered timely because the New York County Action – commenced on December 17, 2013 – served to toll the running of the statute of limitations. EB contends that the New York County Action's pendency stopped the statute of limitations clock until at least August 14, 2014 when Justice Oing ordered its dismissal without prejudice. Hence, there were some 4 ½ months left on the clock when EB sued in New York County, the commencement of this action in Westchester on September 8, 2014 should be considered timely. The Court does not agree.

It is elementary that the statute of limitations begins to run when the claim accrues and timeliness is measured as of the date that the lawsuit in question was commenced (CPLR 203). While it is true that under certain circumstances, the timely commencement of an action will give rise to a tolling of the statute of limitations, the toll operates in a different manner than EB asserts it does. Pursuant to CPLR 205(a), if a prior action is dismissed (other than on certain grounds), the plaintiff may bring a new action within six months of the dismissal (*see generally Marrero v Crystal Nails*, 114 AD3d 101, 108-109 [2d Dept 2013] [characterizing CPLR 205(a) as a "tolling provision"]).

EB would have the Court measure the timeliness of the second action by excluding from the calculation the period that the first action was pending. This is not sanctioned by CPLR 205(a) and is not supported by any of the three authorities that EB

cites.

In *Matter of Spodek v New York State Commr. of Taxation and Fin.* (85 NY2d 760 [1995]), there was no prior action. The question before the Court of Appeals was simply whether the filing of initiatory papers, on the last day prior to the expiration of the statute of limitations, with the Clerk of the Appellate Division, which court was not an e-filing court, was sufficient to "toll" the statute of limitations, even though the papers were not served until after the statute had otherwise lapsed. The Court held that the filing of the papers with the Clerk of the Appellate Division was within the scope of CPLR 304 and therefore the proceeding should be deemed to be timely commenced when so filed (*Matter of Spodek, supra*, 85 NY2d at 766). The *Spodek* case involved whether the claim had been properly interposed by mere filing with the Clerk. To the extent the Court framed the issue as involving a "tolling", it was referring to a "tolling" between the time of filing and the time of service, since the Appellate Division was not a court in which cases are commenced by filing. Here, this Court is a commencement-by-filing court and the issue that arose in *Spodek* is not present here. And *Spodek* had nothing to do with a "tolling" by virtue of a prior litigation.

Perrin v McKenzie (266 AD2d 269 [2d Dept 1999]) is also of no assistance to EB. There, the action was commenced by filing and, upon service, the defendant told the plaintiff that the defendant's name was listed in the caption incorrectly. The defendant moved to dismiss as time barred and the plaintiff moved to amend the caption. Supreme Court, affirmed by the Appellate Division, granted plaintiff's motion and denied defendant's. Clearly, this had nothing to do with the effect of a prior action. EB seizes on language in the Second Department's decision – "The filing of the summons and verified complaint on August 4, 1998 in the Kings County clerk's office effectively tolled the Statute of Limitations in this matter" (*Perrin, supra*, 266 AD2d at 270). It is clear by "this matter" the Second Department was referring to the lawsuit that was before the court, *i.e.*, the lawsuit in which compliance with the statute of limitations was being determined.

This brings to the last of the three cases cited by EB on this point – *Fuentes v Nassau County Health Care Corp.* (2010 NY Slip Op 33828[U], 2010 WL 9595315 [Sup Ct Nassau County 2010). There, plaintiff purchased an index number, filed an RJI and moved for pre-litigation discovery, which motion was denied. The plaintiff then served defendants with a summons and complaint, without having purchased a new index number, and then filed the papers under the old index number. The plaintiff only purchased a second index number and filed the initiatory papers thereunder after the statute of limitation had expired. The defendants moved to dismiss, arguing that the first filing was a nullity and the second filing was too late. The court ruled for the plaintiff, holding that where "the subsequent action is an 'adjunct' to the first action, it arose out of the same transaction or occurrence and is by and against the

same parties, the subsequent action does not require a new index number to be validly commenced."

Fuentes has nothing to do with the present issue. This is not a circumstance where EB, having filed litigation of some sort against McGladrey in New York County, proceeded to use the same New York County index number for purposes of another lawsuit against McGladrey. Here, EB commenced a new and separate litigation against McGladrey in a different county, judicial district, and judicial department. While EB certainly could have filed its amended complaint in New York County without a new index number, EB has not shown that its purchase of a new index number in Westchester County for the present action was unnecessary. To the contrary, the Westchester County Clerk is required by statute to charge a fee for an index number unless an exemption applies (CPLR 8018). While there is an exemption for a fee in situations in which venue is changed by court order (CPLR 8018[b][2]), that is not what happened here.

If EB's interpretation were correct, CPLR 205(a) – offering six months from dismissal of a prior action – would be largely, if not wholly, unnecessary since the entire period that a prior action was pending would not count. Moreover, plaintiff's interpretation would effectively eliminate the conditions precedent that the Legislature has attached to the invocation of CPLR 205(a), such as the very one that EB seeks to avoid – voluntary discontinuance. And, as McGladrey points out, EB's interpretation would also render CPLR 203(f) – the "relation back" concept – superfluous. CPLR 203(f) deems a claim in a related proceeding to relate back, for limitations purposes, to the time the original claims were interposed. Such a "relation back" would be unnecessary if the statute of limitations was tolled during the entire pendency of the litigation.

Since this action was commenced more than two years after the audit report, the action is untimely unless EB gets the benefit of the additional six months offered by CPLR 205 (a). The Court concludes that CPLR 205(a) does not apply because EB voluntarily discontinued the New York County Action.

The August 14, 2014 dismissal order entered by Justice Oing did not result in the termination of the New York County Action, as this Court has already held. What led to the termination of the New York County Action was EB's request for the entry of a judgment of dismissal. EB wanted to have its case dismissed so that it could pursue the present litigation instead of the New York County Action. As its counsel informed Justice Oing, in a letter of January 7, 2015, EB elected, instead of persisting in the New York County Action, to pursue its claims in this action in Westchester County

(Rendón Aff., Ex. 15).[3] Since the August 14, 2014 dismissal was insufficient to terminate the New York County Action (as determined by this Court's stay order), EB then sought to have a judgment entered in order to achieve complete termination of the New York County Action, effectively foregoing the opportunity to replead **what** Justice Oing had extended.

Justice Oing certainly viewed EB's request for a judgment to be the equivalent of a voluntary discontinuance. His judgment reflects his observation that EB is deemed to have elected to voluntarily discontinue the New York County Action.

EB asks that this Court ignore Justice Oing's statement in the judgment, arguing that these non-decretal paragraphs in a judgment have no legal effect. The Court does not agree.

CPLR 5011, providing for the required form and content a judgment, states that a judgment "shall refer to, and state the result of, the verdict or decision, or recite the default upon which it is based." Here, EB's proposed judgment would have mentioned only the August 14, 2014 order and the so-ordered transcript as the legal authority for the judgment (Rendón Aff., Ex. 13). Justice Oing properly recognized that this was an insufficient basis for the judgment, since judgment was actually ending the New York County Action, without EB having either attempted to replead or having stipulated that it choose not to do so.[4] Further, EB submitted the judgment without having been asked by the Court to submit one. Thus, this Court views Justice Oing's reference to EB being deemed to have voluntarily discontinued as being in the context of stating, as required by CPLR 5011, the legal basis for the signature and entry of the judgment:

> for the reasons stated in the Court's Order and the So-Ordered Transcript of the oral argument proceedings before the Honorable Jeffrey K. Oing on August 14, 2014, and because EB Brands is deemed to have elected to voluntarily discontinue the above-captioned action by waiving its right to replead and/or appeal & considering the parties' proposed judgments, it is hereby

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[3]Of some interest, counsel asserted that, in order to avoid a statute of limitations bar, EB "was required to file its new lawsuit within 6 months of Your Honor's August 14, 2014 decision, which tolled the limitations period for 6 months."

[4]EB simply submitted its proposed judgment for settlement with**out** explanation. It did not write to Justice Oing to explain its position until McGladrey first wrote to Justice Oing and articulated its objections.

EB's reliance on *Kenyon & Eckhardt, Inc. v 805 Third Avenue Co.* (84 AD2d 507 [1st Dept 1981], *lv dismissed* 55 NY2d 825 [1981]) for the proposition that courts "regard only those paragraphs which have 'ordered, adjudged, decreed' as the judgment itself" is taken out of context and exaggerated. What the Appellate Division actually stated was:

> The "order and judgment" is a melange of clauses, some, applicable primarily to motions, merely ordering. They create no difficulty, applicable as to matters not now in dispute. We regard only those paragraphs which have "ordered, adjudged, decreed and declared" as the judgment itself (*Kenyon & Eckhardt, Inc.,* 84 AD2d at 509).

Thus, *Kenyon & Eckhardt* held only that, for purposes of that case, the Appellate Division would regard only the paragraphs that included certain language as being the judgment, while other paragraphs, far from not being given any effect, were regarded as "merely ordering." In *Hidaglo v 4-34-68, Inc.* (117 AD2d 798 [2d Dept 2014]), the Second Department held it was improper to include findings of fact and conclusions of law in a judgment but there, the Appellate Division was concerned with a judgment that made such findings and conclusions, rather than merely recited a decision which itself contained them. Indeed, in *Hidalgo,* the judgment contained findings of fact and conclusions of law which were preceded by the words "ORDERED, ADJUDGED, and DECREED." Here, the paragraph in question is preceded by the recitals and is introduced by the word "NOW" and is clearly an explanation as to the legal basis for the entry of judgment.

Moreover, this Court cannot ignore that, in stipulating *inter alia*, to jointly request that this Court vacate the stay of proceedings, counsel adopted as a predicate to their stipulation the very language used by Justice Oing:

> WHEREAS Justice Jeffrey K. Oing, for the reasons stated in the Court's Order dated August 14, 2014 and entered on August 18, 2014, and because EB Brands is deemed to have elected to voluntarily discontinue the New York Action, entered a final judgment of dismissal without prejudice in the New York Action on January 28, 2015;

This stipulation, this Court believes, constitutes an admission on behalf of EB that its actions in procuring the New York County Judgment warranted that it be "deemed to have elected to voluntarily discontinue the New York County Action."

Even if Justice Oing had not already concluded that EB should be

deemed to have voluntarily discontinued the New York County Action, and even if EB had not already acknowledged that its steps to obtain the judgment gave rise to it being deemed to have voluntarily discontinued, the Court would independently decide that EB's action brought about a voluntary discontinuance.

The purpose of CPLR 205(a) is to "provide a second opportunity to the claimant who has failed the first time around because of some error pertaining neither to the claimant's willingness to prosecute in a timely fashion nor to the merits of the underlying claim. The statute by its very nature is applicable in those instances in which the prior action was properly dismissed because of some fatal flaw" (*George v Mt. Sinai Hosp.*, 47 NY2d 170, 178-179 [1979]). Here, the New York County Action was terminated because EB was unwilling to prosecute it and because EB did not care for Justice Oing's view of the merits of the action.

Had Justice Oing's order specified a time within which EB could replead, EB could have allowed that time to elapse, obtained the benefit of six months measured from the lapse point, and not have been charged with voluntary discontinuance (*see Maki v Grenda,* 224 AD2d 996 [4th Dept 1996]). Thus, where the specified time to replead had already elapsed, a subsequent stipulation to voluntarily discontinue was "an insignificant gesture with respect to the right to bring another action and cannot be deemed as a voluntary discontinuance of the previous action" (*Storch v Gordon*, 37 Misc 2d 731, 732 [Sup Ct, Kings County 1963]). But, here, Justice Oing did not specify a time within which repleading had to occur and, therefore, something further of significance was required in order to eliminate the opportunity to replead, eliminate a potential for appeal, and to close out the New York County action so as to proceed in this Court.

The closest case found is *Friedman v Long Island R. Co.* (273 App Div 786 [2d Dept 1947], *affd* 298 NY 702 [1948]). There, the plaintiff consented to the granting of defendant's motion to dismiss the complaint for lack of subject matter jurisdiction and an order was entered thereon providing for a judgment in favor of defendant. The Appellate Division held that the prior action terminated by voluntary discontinuance when the plaintiff consented to the dismissal of the complaint. Here, EB effectively consented to the judgment dismissing its complaint; indeed, it voluntarily proposed the entry of such a judgment on its own, without request from either opposing counsel or the Court. Had nothing happened, this action would have remained stayed. Hence, it must be said that it was by EB's own voluntary action that its New York County Action was terminated.

While this result may seem harsh, it must be borne in mind that this situation is one of EB's own deliberate creation. EB, as will be discussed *infra*, asserts that it has satisfied Justice Oing's concerns with its pleading. EB could have readily

had Justice Oing determine whether the revised pleading is viable without all of the delay and procedural wrangling that has been attendant to EB's decision to abandon its first-chosen New York County venue in favor of a second litigation here in Westchester. Concerns that a litigant would flit between forums, if not out-right forum shop, warrant holding that litigant to the strict measure of the statute of limitations provisions in order to deter such conduct. Apart from the delay in the determination of the issues, this Court has been compelled to review matters already quite familiar to Justice Oing, a consequence that is injurious to judicial economy. The extensive time involved in the decisional process on this motion (let alone the time involved in the prior motion practice) is precious time that could have been more productively devoted to the cases filed here in the first instance.

THE PRESENT ACTION IS BARRED BY *RES JUDICATA*

It is well settled that where a final judgment is entered dismissing a prior compliant for failure to state a cause of action, that determination, whether right or wrong, is a bar to another action for the same cause, unless the defects or omissions adjudged to be present in the one action are corrected or supplied by the pleadings in the other (*Linton v Perry Knitting Co.*, 295 NY 14, 17 [1945]; *accord, 175 East 74th Corp. v Hartford Acc. & Indem. Co.*, 51 NY2d 585, 590 n1 [1980]; *Avins v Federation Empl. and Guidance Serv., Inc.*, 67 AD3d 505, 506 [1st Dept 2009]; *McKinney v City of New York*, 78 AD2d 884, 885 [2d Dept 1980]).

Accordingly, the task falls upon this Court to determine whether EB has corrected the defects and omissions that Justice Oing identified in the New York County Action. As noted above, it would have been far preferable, and in the interests of judicial economy, for EB to have brought this issue to Justice Oing. But it did not. Having been tasked with the question, this Court, having carefully reviewed the transcript of Justice Oing's oral determination, as well as the complaint before Justice Oing, the present pleading, the audit letters and the audit reports themselves, concludes that EB has failed to address the defects and omissions cited by Justice Oing and that, therefore, its present complaint is barred by *res judicata*.

This Court has found three basic defects or flaws in the prior pleading that were identified and determined to exist by Justice Oing: (a) failure to address the provision in the audit letter that released McGladrey from liability in the event of a knowing misrepresentation by EB's management; (b) failure to provide a basis for asserting that McGladrey's audit responsibilities extended to the provision of business management advice; and (c) failure to set forth and address the role of EB's "old management." While the parties focus almost exclusively on the latter two issues in their memoranda (and most of that discussion is on the third point alone), the Court

finds the first identified point to be dispositive.

A. Failure to Address Whether There Was a "Knowing Misrepresentation"

At the heart of this dispute, as identified in all three of EB's pleadings, is EB's contention that McGladrey, in conducting its audits of EB, failed to test whether EB's accounts receivable were being recorded and accounted for at their net realizable value in accordance with generally accepted accounting practices ("GAAP") and failed to test the values of EB's inventory using procedures consistent with generally accepted auditing standards ("GAAS") (*see* initial Complaint in New York County Action [Rendón Aff., Ex. 9] at ¶7; Amended Complaint in New York County Action [Rendón Aff., Ex. 10] at ¶7; Complaint in this Action [Rendón Aff., Ex. 1] at ¶¶7-8). As set forth in the Amended Complaint in the New York County Action, which was before Justice Oing, the thrust of the issue is that, after McGladrey's departure, EB discovered, with the aid of other outside professionals, that there were overstated accounts receivable related to specific retailers who were afforded guaranteed merchandise returns and/or guaranteed gross profit margins (Rendón Aff., Ex. 10, at ¶46).

The engagement letter between EB and McGladrey, dated December 19, 2011 (Rendón Aff., Ex. 4), which is annexed to the Complaint, contains specific provisions limiting the scope of McGladrey's obligations and liabilities. Among them are provisions which impose certain responsibilities on EB's management and its Board of Directors and which exonerate McGladrey from liability in the event of a knowing misrepresentation by a member of EB's management:

> Because [McGladrey] will rely on EB Brands and its management and audit committee to discharge the foregoing responsibilities, EB Brands holds harmless and releases [McGladrey], its partners, and employees from all claims, liabilities, losses and costs arising in circumstances where there has been a knowing misrepresentation by a member of EB Brands' management which has caused, in any respect, [McGladrey's] breach of contract or negligence. This provision shall survive the termination of this arrangement for services (*id.* at 2).

Justice Oing, in his decision, after quoting this language stated:

> I don't find that there is any allegation in this complaint or in this record here that I can flesh out and amplify the pleadings that would satisfy that provision so as to assert a claim for breach of contract and negligence against the defendant (NYTr. at 89).

The very same defect appears in the present Complaint before this Court. There is literally nothing that alleges that the claimed malpractice or errors by McGladrey occurred notwithstanding the absence of any misrepresentation by any member of EB's management. There is nothing that alleges that any misrepresentation by EB's management was "unknowing" or that any misrepresentation by an EB employee was made by someone who was not a member of EB's management. There is nothing that alleges that any knowing misrepresentation by a member of EB's management did not cause the claimed breaches by McGladrey.

There is no allegation that EB failed to provide information regarding its accounts receivable and inventories to McGladrey; rather, the contention by EB is that the audit of those figures resulted in an overstatement. However, in its present pleading, and notwithstanding Justice Oing's decision, EB utterly fails to address what, if anything, EB's management told McGladrey about the accounts receivable and inventories, much less appropriately allege a basis for putting the responsibility on McGladrey, as opposed to EB, for misstatement of the accounts receivable and inventories. As Justice Oing remarked early on in the argument before him: "I didn't see anything in this complaint that alleges fraud or misstatements. So that the way I look at it is that the numbers were coming in to the defendants, the source of it had to be you guys [*i.e.*, EB]" (NYTr. at 18).

Stated directly, nothing in EB's present complaint "fleshes out and amplifies" the pleading so as to "satisfy" the referenced provision of the contract so as to support a claim for breach of contract and/or negligence as against McGladrey.

B. Failure to Provide a Basis for Asserting that McGladrey's Obligations Extended to the Provision of Business Management Advice

Justice Oing specifically cited to Paragraph 46 of the Amended Complaint wherein it was alleged there were overstated accounts receivable related to specific retailers who were afforded guaranteed merchandise returns and/or guaranteed gross profit margins (NYTr. at 79). Justice Oing characterized this allegation as "the rub of this entire lawsuit" (*id.*).

Justice Oing expressed that there was nothing in the engagement letter that obligated McGladrey to conduct "some sort of management review or policy review to tell the plaintiff that their way of doing business was not a good way of doing business" (*id.* at 87). He stated, expressly citing Paragraph 46, that it was EB's relationship with the retailers that resulted in the alleged overstated account receivables and there was nothing from which the Court could determine whether McGladrey had an obligation to tell EB's management how to run their business (*id.* at 87-88).

This Court gleans from Justice Oing's remarks that he viewed the

pleading before him as insufficient because it attributed the accounts receivable/inventory issue to business decisions by which EB agreed to give certain retailers favorable return provisions and/or guaranteed profit margins. Thus, the pleading failed to adequate allege that McGladrey's alleged failure to discover these business terms was an audit failure.

In the present Complaint, EB reiterates that McGladrey failed to ascertain that millions of dollars recorded in accounts receivable were not set forth at their actual realizable value but were recorded at an uncollectible inflated value (Rendón Aff., Ex. 1 at ¶9). Again, EB alleges that the overstatement of receivables masked operating losses which, subsequent to McGladrey's involvement, were traced to specific retail relationships that included guaranteed return rights and gross margins. EB now alleges these relationships "were, and always could have been, readily restructured in order to avert operating losses" (*id.* at ¶17). EB now alleges that, under specific, cited professional standards, McGladrey was required to test the value of EB's accounts receivable by seeking appropriate confirmations from third parties (*id.* at ¶¶37-48). EB now adds specific paragraphs that address the issue of the retailers with special arrangements:

> 61. Specifically, McGladrey actually reviewed EB Brands' contracts with certain key retailers responsible, together, for approximately 35% of the approximately $40 million in stated year-end accounts receivable for 2009, 2010, and 2011. McGladrey had actual knowledge that these agreements contained guaranteed return and gross margin provisions, which raised the risk that the accounts receivable values stated on the Company's financial statement were higher than the payable balances the retailers believed they owed to EB Brands (*i.e.*, because they might have returned some of the merchandise bought from EB Brands and invoiced by the Company).
>
> 62. Yet despite having actual knowledge of these circumstances, McGladrey failed to conduct any meaningful testing of the accounts receivable values attributed to these key retailers – effectively choosing not to audit between $30 million and $50 million of stated asset value on the Company's financial statements. This failure was a direct and gross breach of GAAS, including but not limited to AU-C 530.05-530.08, and was tantamount to willful blindness.

Putting aside EB's continued assertion that the retail relationships were capable of being restructured earlier and would have been but for McGladrey, the allegations in Paragraphs 61 and 62 make it clear that EB is not complaining that McGladrey failed to advise it to change its business relationship with key retailers; rather, EB is alleging that McGladrey failed to properly audit the account receivable numbers based on the then existing business relationships. The Court reviews this as sufficient to address Justice Oing's articulated concerns.[5]

C. Failure to Set Forth and Address the Role of EB's "Old Management"

The third point is the one that received the most, and almost exclusive, attention from counsel in their memoranda of law on this motion.[6] In the New York County pleadings, EB alleged that, in late 2012, EB replaced its senior management and new management terminated EB's relationship with McGladrey and retained new accounting professionals. It was, alleged EB, the new management, with assistance from outside professionals, who determined that EB's operating losses were traceable to specific, adverse retail relationships and/or guaranteed return and gross margin programs (Rendón Aff., Ex. 9 at ¶¶9-10; Rendón Aff., Ex. 10 at ¶¶9-10).

Justice Oing addressed these allegations, stating:

> I have here everything that new management did. I don't have any allegations here [about] what old management did and whether or not old management would have done something differently had the issue of the overstated account receivables [been] brought to their attention. It's absolutely silent with respect to the old management, and that would put, I think, the plaintiff in a precarious position because that would mean that they would have to put on record that the old management didn't do their job properly and that what they were doing was not a proper course of business. And to fall on a sword like that is kind of precarious for a plaintiff to assert against their old management. In the end, it's the board that controls. The board is in charge. But the board acts based on what the management tells them.

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[5]However, as will be discussed *infra,* there are other problems that these allegations do not address.

[6]This degree of attention may be due to Justice Oing's comment that this issue was "more important" than a prior one being discussed (NYTr. at 89).

> So without the allegations about what old management did, what were the inner workings of old management, how these relationships developed – because you have to understand, the record here indicates that as of 2012, the new management came in. Well, that's all right after the fact, when the meltdown has already occurred. So we don't know what the purpose of the replacement was, why there was a replacement, who initiated the replacement, whether or not the board finally figured out that at that point the internal workings or the relationships they had with their clients, the retailers, was not good for the company.
>
> All of those things need to be fleshed out in the complaint for this Court to believe that there is a sufficient cause of action or sufficiently stated against the defendants as auditors here (*id.* at 89-91).

Again, as Justice Oing expressed it earlier in the argument before him, the issue distills to: "How do I know from this complaint whether or not it's the old management's fault?" (*id.* at 18).

In the present Complaint, the references to replacement of "senior management" and the installation of "new" management were deleted. Instead, EB alleges that, by 2012, it had exhausted its debt facilities and faced bankruptcy and, to uncover why EB was struggling though it had apparently strong receivables, the Board of Directors made the Chief Operating Officer the new Chief Executive Officer, terminated McGladrey and brought in a new CPA firm (Rendón Aff., Ex. 1 at ¶¶16-17). In addition, in several instances, EB refocused its malpractice allegations against McGladrey so as to allege that McGladrey should have caused management to make certain revisions to the financial statement and, if management declined, McGladrey should have taken the issue to the board (*see ,e.g. id.* at ¶¶65, 81). Further, instead of referencing the actions that EB's management and board would have taken had McGladrey performed its obligations, EB now focuses on the actions that the board alone would have directed or which it did take (*see, e.g., id.* at ¶¶82, 83).

In opposition to the motion to dismiss, EB argues that McGladrey succeeded in having Justice Oing adopt McGladrey's mischaracterization of EB's pleading. EB states that it perceives that Justice Oing understood that EB was alleging: (1) "old management" had been swapped out for new management; (2) "new management" took over and improved operations; and (3) EB was trying to blame McGladrey for "old management's" failures (Plf Opp. Mem. at 12-13). EB asserts that, in fact, such was not EB's claim and that the "false dichotomy" between "old management" and "new management" is a "factual straw man invited by McGladrey"

(*id.* at 13). EB contends that it made more than 60 changes to clarify its claim is based on McGladrey's failure to report honestly to the board of directors, in violation of auditing standards (*id.*).

In assessing whether EB has rectified the deficiencies identified by Justice Oing, for purposes of *res judicata*, it does not matter whether Justice Oing's determination was right or wrong. The judgment of dismissal is final and binding. Thus, EB cannot now be heard to argue that Justice Oing erred in adopting or accepting a mischaracterization of EB's pleading. If EB perceived that Justice Oing had misapprehended EB's pleading, its proper remedy was to seek to reargue or, alternatively, to appeal the dismissal order. Instead of doing either of those things, EB decided to sue in Westchester and then to elect to pursue a path to finalize the New York County Action and give the determination therein *res judicata* effect.

As previously stated, in order to survive a *res judicata* dismissal, EB was required to correct the defects and deficiencies previously adjudged to exist in the prior complaint. It did not do so.

Justice Oing found the pleading before him insufficient because it failed to contain allegations as to what "old management" did, what were the inner workings of "old management", why management was replaced, who initiated the replacement, and whether the board figured out that EB's relationships with the retailers were not good for EB. None of these matters are addressed; rather, EB has simply tried to paper them over with generic references to the board and by alleging, in essence, that Justice Oing was hood-winked on this point by McGladrey.

To the extent that EB would now suggest that it could not amplify what happened with "old management" and the retention of "new management" because EB never used the term "old management" in its New York County pleadings, its argument is utterly fatuous. While EB did not use the term "old management" in its New York County pleadings, it did state clearly that, in late 2012, EB "replaced its senior management [and] [n]ew management terminated [EB's] relationship with McGladrey" (Rendón Aff., Ex. 9 at ¶¶9-10).

When "new" management arrived, it necessarily made the prior management the "old" management. It would make absolutely no difference if, instead of calling the pre-2012 senior management who was replaced in 2012 the "old" management, that management was called the "former" management, or the "prior management" or the "terminated" management or some other term sufficient to indicate that the group in charge prior to the change was no longer in charge.

Further, even EB's present pleading indicates that in 2012, the board elevated the Chief Operating Officer to CEO. This implies a change in management.

In a footnote to its memorandum of law, EB takes that the reference to "new" management was offered to provided context for why EB terminated McGladrey and hired KPMG (Plf Opp. Mem. at 13 n3). This contention reveals the fallacy in EB's argument. The statement in the pleading does not state "why" EB terminated McGladrey; it identifies "who" terminated McGladrey. Why EB terminated McGladrey is not explained and Justice Oing held it should have been.

In any event, it was incumbent, pursuant to Justice Oing's determination, for EB to provide allegations to amplify what happened in 2012 by way of management change. If nothing else, EB was required to explain what role, if any, the Chief Operating Officer, who became the CEO in 2012, had in the matters which are the subject of the lawsuit and, what, if anything, prompted the change in accounting/audit firms.

For these reasons, EB's present Complaint must be dismissed for failure to address the deficiencies identified by Justice Oing.

INDEPENDENT OF THE PRIOR DETERMINATION, EB'S COMPLAINT FAILS TO SUFFICIENTLY ALLEGE A PROPER BASIS FOR LIABILITY AGAINST McGLADREY

Apart from the prior determination of Justice Oing, and even if this action were timely, the Court would conclude, on its own independent review of the Complaint before it, that EB has failed to sufficiently set forth a basis for liability against McGladrey.

This Court observes, just as Justice Oing did, that the engagement agreement entered into between EB and McGladrey contained a release by which EB agreed to hold McGladrey harmless and release it "from all claims, liabilities, losses and costs arising in circumstances where there has been a knowing misrepresentation by a member of EB Brands' management which has caused, in any respect, [McGladrey's] breach of contract or negligence." The Court may properly consider this release language given that EB specifically annexed copies of the engagement letters to its Complaint (*see* Rendón Aff., Ex. 1 at ¶33; *see, e.g.,* CPLR 3104; *805 Third Ave. Co. v M.W. Realty Assoc.,* 58 NY2d 447, 451 [1983]) and, in any event, the engagement letters – constituting the parties' contracts, the terms of which are undisputed – qualify as documentary evidence for purposes of McGladrey's documentary evidence defense (*see, e.g., Fontanetta v Doe*, 73 AD3d 78, 84-86 [2d Dept 2010]).

At the heart of EB's claims against McGladrey are the contentions that McGladrey, as EB's auditor, failed to audit, verify or test the inventory and accounts receivable statements as recorded by EB through its management (see Rendón Aff.,

Ex. 1 at ¶¶10-11, 32-36). Consequently, this Court agrees with Justice Oing that since the underlying theory of breach of contract and negligence against McGladrey necessarily implicates statements, documents or information provided to McGladrey by EB, it is incumbent upon EB to allege whether there were any misrepresentations made to McGladrey by any member of EB's management and, if so, whether any such misrepresentations were "knowing" or not; and if so, whether such knowing misrepresentation did not cause McGladrey's breach of contract or negligence. The point is really quite simple: pursuant to the agreement of the parties, if any member of EB's management knowingly misrepresented the accounts receivable or inventory, then any breach of contract or negligence on McGladrey's part in not catching the misrepresentation does not rise to liability against McGladrey, except if the knowing misrepresentation did not cause in any respect McGladrey's acts or omissions. Pursuant to the engagement letter, McGladrey, no matter its own malfeasance or nonfeasance is not liable if a knowing misrepresentation by EB's management caused, in any respect, McGladrey's breach of contract or negligence. Hence, EB was required to address this issue in its pleading.

The importance of this point is brought home by a review of the 2011 audit report, dated May 4, 2012 (Rendón Aff., Ex. 7). This audit report, while not annexed by Plaintiff, is quoted, at length in the Complaint (Rendón Aff., Ex. 1, at ¶¶68, 75). A copy of the audit report has been submitted by McGladrey and Plaintiff has not objected to its consideration or disputed its authenticity. In any event, to the extent that McGladrey's motion is predicated upon its contention a defense is based on documentary evidence, the audit report may be considered sufficiently documentary in character (*see, e.g., Fontanetta v Doe*, 73 AD3d 78, 84-86 [2d Dept 2010]) as the authenticity of the audit report is unchallenged. In addition, there are several cases that support the view that, on a motion to dismiss, a court may consider documents referenced in a complaint even though the pleading fails to attach them (*Alliance Network, LLC v Sidley Austin LLP,* 43 Misc 3d 848 [Sup Ct, NY County 2014]; *Deer Consumer Prod., Inc. v Little*, 2011 NY Slip Op 51691[U], 32 Misc 3d 1243[A] [Sup Ct, NY County 2011]).

The Complaint herein alleges that the trade receivables reported in 2011 audit report were $45,262,000, net of allowances of $5,024,000 and EB's subsequent CPA determined that these allowances were insufficient by millions of dollars such that EB's accounts receivable and its earnings were materially overstated (Rendón Aff., Ex. 1 at ¶¶68). This is reflected in the audit report (Rendón Aff., Ex. 7, at 2). However, the chart containing this information refers to Notes and the following Note appears with respect to trade accounts receivable:

> Trade Accounts Receivable: Trade accounts receivable are carried at original invoice amount, less an estimate made for doubtful receivables. The allowance for doubtful accounts is

> established through a provision for bad debts charged to expenses. **Trade receivables are charged against the allowance for bad debts when management believes that the collectibility of the principal is unlikely.** Recoveries of trade receivables previously written off are recorded when received. No interest is charged on customer accounts. **The allowance is an amount that management believes will be adequate to absorb estimated losses on existing accounts receivable, based on an evaluation of the collectibility of the accounts receivable and prior bad debt experience**. This evaluation also takes into consideration such factors as changes in the nature and volume of the accounts receivable, overall accounts receivable quality, review of specific problem accounts receivable and current economic conditions that may affect the customer's ability to pay. **While management uses the best information available to make the evaluation**, future adjustments may be necessary if there are significant changes in economic conditions (*id.* at 10 [emphasis added]).

The Court also observes that, in a separate note relating to revenue recognition, the following appears:

> Sales are recognized as revenue when products are shipped. The Company offers its customers a variety of sales and incentive programs. As part of the Company's seasonal gift programs, selected customers are offered a guaranteed sales program. The guaranteed sales program allows the customer the ability to return unsold merchandise at the end of a particular program after an appropriate return authorization number is obtained. Sales under guaranteed sales programs are recorded when the product is shipped and an accrual is recorded for estimated sales returns. The Company also offers certain customers advertising allowances and markdown allowances based on meeting certain sales targets. In connection with guaranteed sales programs, the Company experiences significant sales returns that arise from seasonal sales. As a result, **a provision for estimated sales returns are recognized based on historical sales return rates and sales contracts in effect, which is an amount management**

believes will be adequate to provide for future returns (*id.* at 12 [emphasis added]).

From these notes to the audit report, it is clear that much, if not all, of the problems that EB complains about relate to information and opinion provided by EB's management to McGladrey, which information and opinion was noted in the audit report. While EB has supplied significant allegations relating to the specific duty of auditors in auditing inventory and accounts receivable (Rendón Aff., Ex. 1 at ¶¶45-52), and such allegations would doubtless be sufficient but for the release from liability contained in the engagement letter, EB has completely failed to acknowledge that its management made representations to McGladrey, much less allege that such representations were not misrepresentations, or if so, were not made knowingly, or if so, did not cause any of the claimed acts or omissions by McGladrey.

Hence, the Court independently concludes that EB has failed to state a cause of action against McGladrey for breach of contract or negligence and that any such cause of action is precluded by documentary evidence.

INDEPENDENT OF THE PRIOR DETERMINATION, EB'S COMPLAINT FAILS TO SUFFICIENTLY ALLEGE THAT McGLADREY'S CONDUCT CAUSED THE DAMAGES SOUGHT

EB presents three causes of action: negligence, gross negligence and breach of contract. The reason for this multiplicity of theory is that the engagement letter limits McGladrey's liability for damages to the amount of the fees paid to it EB, which contractual limitation is not enforceable with respect to grossly negligent conduct (*see Colnaghi, U.S.A., Ltd. v Jewelers Protection Servs., Ltd.*, 81 NY2d 821, 823-824 [1993]).

As previously discussed, EB's claims center on the allegation that McGladrey failed to adhere to proper professional standards in auditing the accounts receivable. EB alleges that McGladrey's audit reports were reckless and inaccurate and EB specifically quotes from the May 4, 2012 audit report in which McGladrey represented that it conducted its audits in accordance with generally accepted auditing standards (Rendón Aff., Ex. 1 at ¶75). EB asserts that McGladrey could not simply accept management's assertions at face value and was obligated to engage in external confirmation procedures for accounts receivable (*id.* at ¶¶43-45) and likewise engage in confirmatory activity with respect to inventory (*id.* at ¶49).

EB alleges that, because of McGladrey's failures, EB's board perceived that EB was financially strong, though it was actually losing money. By 2012, EB had exhausted its debt facilities and faced bankruptcy (*id.* at 15-16). After McGladrey was

terminated, EB traced the operating losses to the specific retail relationships that had guaranteed return rights and gross margins (*id.* at 17). These relationships were, and always could have been restructured to avoid the losses (*id.*).

EB further alleges that the board directed that management take corrective actions, including terminating or restructuring the retail accounts in question, which resulted in a prompt return to profitability from a loss in 2012 to positive EBITDA of more than $9 million as of December 31, 2013. But before the turnaround occurred, EB was forced to undergo a "massive financial restructuring" in order to continue operations and preserve jobs. In this regard, it took on tens of millions of new debt and the value of its "equity securities", previously valued at $70 million, was wiped out. In all, EB sustained losses of over $100 million (*id.* at ¶¶83-85).

In a malpractice action, the plaintiff must allege, beyond the point of speculation and conjecture, a causal connection between its losses and defendant's actions (*see, e.g., Merz v Seaman,* 265 AD2d 385 [2d Dept 1999]; *Herbert H. Post & Co. v Sidney Bitterman, Inc.*, 219 AD2d 214, 224 [1st Dept 1996]).

EB is engaging in a sort of "bait and switch." To rectify one of the defects found by Justice Oing, EB shifted the focus of its allegations from claiming that McGladrey failed to advise it to change it business relationship with key retailers; rather, EB clarified that it is alleging that McGladrey failed to properly audit the account receivable/inventory numbers based on the then existing business relationships. However, when it comes to damages, EB asserts that had McGladrey done its job properly, the board or EB would have taken action to terminate and/or restructure the key retailer accounts. However, EB does not allege what was the differential in the accounts receivable/inventory numbers between what McGladrey reported and what allegedly should have been reported. Hence, it is purely speculation as to whether the differential was so significant as to have occasioned management or the board to direct a change in the business relationships with key retailers. Nor does EB address the extent to which EB's own management (including the Chief Operating Officer) knew or should have known of the relationships with the key retailers at issue.

EB does not allege whether these relationships were set forth in written contracts of fixed durations. Without that information, it is pure speculation as to the changeability of those relationships. Moreover, as EB impliedly acknowledges, if the key retailers declined to accept the changes sought by EB, EB might lose their business altogether. Further, EB does not assert that the alleged overstatements of accounts receivable were the only materially adverse economic factors causing its near-bankrupt condition.

EB does not describe the terms of its pre-existing credit facility nor explain why or when that credit facility was exhausted. Nor does it set forth why the credit

facility would not have been limited or revoked had EB eliminated the alleged overstatements at an earlier point in time.

Most important, EB does not claim that the allegedly adverse terms of the relationships with the key retailers were known exclusively by McGladrey and does not allege what, if anything, its management was doing with these accounts and what management told McGladrey about these accounts. As previously discussed, the audit report acknowledges the existence of these special sales programs and makes it clear that management was well aware of them.

While it is arguable that EB's complaint sufficiently alleges gross negligence, the complaint does not articulate a basis for attributing the over $100 million in losses to McGladrey's alleged failure to conduct proper audits. Likewise, while it is also arguable that EB has alleged negligence and breach of contract claims, any recovery on such claims would be limited to the amount of the fees paid by EB, which is not the remedy sought.

LEAVE TO REPLEAD MAY NOT BE GRANTED

As noted at the outset, EB stipulated, in the Stipulation of February 18, 2015, to waive any right it had, or may have, whether as of right or by leave of court, to amend its pleading, except under limited circumstances not relevant here. In view of this stipulation, the Court may not grant leave to replead. This action will be dismissed with prejudice.

CONCLUSION

The Court has considered the following papers:

1. Notice of Motion, dated April 1, 2015;

2. Affirmation of Veronica E. Rendón, Esq., dated April 1, 2015, together with the exhibits annexed thereto;

3. Memorandum of Law in Support of Motion dated April 1, 2015;

4 Affirmation of Mary Jane Yoon, dated April 24, 2015, together with the exhibits annexed thereto;

5. Memorandum of Law in Opposition to Motion dated April 24, 2015; and

6. Reply Memorandum of Law dated May 7, 2015.

Accordingly, for the reasons stated and based upon the papers aforesaid, it is hereby

ORDERED that the motion by Defendant McGladrey LLP, f/k/a McGladrey & Pullen, LLP, made pursuant to CPLR 3211(a)(1) (5) and (7), to dismiss the Complaint of Plaintiff EB Brands Holdings, Inc., as time-barred, as barred by *res judicata*, and because of failure to state a cause of action is granted; and it is further

ORDERED that this action shall be, and is hereby, dismissed with prejudice; and it is further

ORDERED that said Defendant shall submit a proposed judgment, together with any bill of costs, noticed for settlement, pursuant to 22 NYCRR §202.48, before this Court by not later than August 7, 2015 at 9:30 a.m.

The foregoing constitutes the Decision and Order of this Court.

Dated: White Plains, New York
July 20, 2015

ENTER:

ALAN D. SCHEINKMAN
Justice of the Supreme Court

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