SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 54

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FIRST CENTRAL SAVINGS BANK, JOSEPH PISTILLI, JAMIE PISTILLI, ANTHONY PISTILLI, DONNA PISTILLI, DANIEL BENEDICT, REENA BENEDICT, DONALD A. CORDANO, ANDREW C. PRESTI, EILEEN PRESTI, SPIRO KONSTANTINIDES, as Trustee of the Savas Konstantinides 2012 Family Trust, as Successor in interest to Savas & Sophia Konstantinides, and ANDREW LATOS,

Plaintiffs,

-against-

PARENTEBEARD, LLC and BAKER TILLY VIRCHOW KRAUSE, LLP,

Defendants.

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Index No.: 653680/2014

DECISION & ORDER

SHIRLEY WERNER KORNREICH, J.:

Defendants ParenteBeard LLC (Parente) and Baker Tilly Virchow Krause, LLP (Baker) move, pursuant to CPLR 3211, to dismiss the amended complaint (the AC). Defendants' motion is granted in part and denied in part for the reasons that follow.

I. Procedural History & Factual Background

The court assumes familiarity with its decision on defendants' motion to dismiss the original complaint, which is set forth in an order dated October 13, 2015. *See* Dkt. 23 (the Prior Decision).[1] The core allegations in the AC (*see* Dkt. 28), filed by plaintiffs on December 4, 2015, are virtually identical to those in the original complaint. The AC simply contains additional facts to remedy the pleading deficiencies identified in the Prior Decision.

[1] References to "Dkt." followed by a number refer to documents filed in this action on the New York State Courts Electronic Filing system (NYSCEF). It should be noted that the court continues to assume for the purpose of this motion to dismiss that Baker may have successor liability because it has not submitted any non-conclusory evidence that it does not.

In short, this case concerns the IRS's disallowance of $2,514,143 in net operating losses (the Tax Benefit) claimed by plaintiff First Central Savings Bank (the Bank) on its 2010 tax return. The IRS disallowed the Tax Benefit because, despite promising to do so, Parente failed to file a Form 7004 seeking a filing deadline extension on behalf of the Bank. The Bank was not informed by the IRS of the disallowance of the Tax Benefit until 2012. Prior to that revelation, in 2011, Parente prepared a September 30, 2010 financial statement for the Bank (the Financial Statement) based on the assumption that the Bank was entitled to claim the Tax Benefit. The Bank, relying on the Financial Statement, conducted a Preemptive Rights Offering (the PRO) in which it sold stock to its shareholders – including the individual plaintiffs (the Shareholder Plaintiffs), some of whom were on the Bank's board of directors. The Shareholder Plaintiffs allege that they relied on the value of the Bank, as depicted in the Financial Statement, in deciding to purchase additional shares of the Bank at the offering price of $7 per share.

The AC contains three causes of action in which: (1) the Bank asserts a claim of negligence for Parente's failure to timely file the Form 7004, which caused the Bank to lose the Tax Benefit; (2) the Bank asserts a claim of negligence for Parente's inclusion of the value of the Tax Benefit on the Financial Statement, which caused the Bank myriad alleged damages, such as having to retain and pay another accounting firm to deal with the Tax Benefit disallowance; and (3) the Shareholder Plaintiffs assert a claim of negligent misrepresentation due to their purchase of shares in the PRO at an inflated $7 per share valuation, when such valuation would have been lower had the value of the Tax Benefit not been included on the Financial Statement.

On December 23, 2015, defendants filed the instant motion to dismiss the AC. Defendants do not move to dismiss the first cause of action. Nor do they seek dismissal of the second cause of action for failure to plead damages because the AC, unlike the original

complaint, clearly does so.[2] The issues on their motion are whether (1) the Bank has stated a claim that Parente's preparation of the Financial Statement was negligent; (2) the Shareholder Plaintiffs have properly pleaded the requisite near-privity and linking conduct to sustain their tort claim against Parente, an accounting firm with which they were not in contractual privity; and (3) plaintiffs pleaded a basis to maintain a claim for attorneys' fees. The court will not address the third issue, plaintiffs' attorneys' fees demand, because it was stricken in the Prior Decision [*see id.* at 12] and the AC proffers no new basis for such demand. The court reserved on the motion after oral argument. *See* Dkt. 57 (5/19/16 Tr.).[3]

II. Discussion

The standard on a motion to dismiss is set forth in the Prior Decision and will not be repeated here. *See id.* at 5-6. Simply put, the court assumes the AC's well pleaded allegations to be true for the purposes of this motion and will only dismiss a cause of action if it fails to state a claim or is utterly refuted by the documentary evidence. *See id.*

Defendants' motion to dismiss the second cause of action – the Bank's claim that Parente negligently prepared the Financial Statement – is denied. Defendants' argument is that Parente had no reason to know that the IRS would disallow the Tax Benefit at the time the Financial Statement was prepared in 2011 (as noted, the Bank found out in 2012). The relevant inquiry appears to be whether a reasonably prudent accountant who arguably should have known that the Bank did not get a filing extension (because the Form 7004 was never received by the IRS) acts negligently when it prepares a financial statement inaccurately portraying the Bank's value, not

[2] This decision should not be construed as the court opining on the appropriate scope of damages claimed in the second cause of action, as that is not an issue the parties raised on this motion.

[3] At the parties' request, the court held the motion in abeyance pending their attempts to settle the case, which have not proven fruitful.

with bad intent, but under a false premise of value (i.e., that the Bank would be able to maintain the Tax Benefit). *See D.D. Hamilton Textiles, Inc. v Estate of Mate*, 269 AD2d 214, 215 (1st Dept 2000) ("A claim of professional negligence requires proof that there was a departure from accepted standards of practice."). To be sure, the parties do not dispute that the Financial Statement would have been correct if the Bank had the right to the Tax Benefit. However, the requisite form to receive such Tax Benefit had not been filed at the time the Financial Statement was prepared. The question of whether, under the somewhat unique facts of this case, Parente acted negligently in preparing the Financial Statement would appear to require, as in most professional malpractice cases, expert testimony.[4] *See Gertler v Sol Masch & Co.*, 40 AD3d 282 (1st Dept 2007); *Tung v Mui*, 260 AD2d 294 (1st Dept 1999). Defendants, who bear the burden on a motion to dismiss of demonstrating that the plaintiff has no claim, did not support their lack of negligence argument with any citation to authority, let alone any analogous case that grappled with similar facts. *See* Dkt. 30 at 8-9. Instead, defendants simply rely on some of the court's dicta in the Prior Decision. *See id.* at 7-8.[5]

Defendants' approach is unavailing.[6] If the court thought that the negligence allegations could not sustain a viable claim, leave to replead would not have been granted. Indeed, in the Prior Decision, the court did not purport to rule on the substantive viability of the negligence

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[4] Questions remain as to whether a reasonable accountant should have known the Form 7004 had not been properly sent at the time the Financial Statement was prepared.

[5] It should be noted that the court's remark that the tax return prepared by Parente was not negligently prepared is of no moment. *See* Prior Decision at 6. Parente sues only for the allegedly negligently prepared Financial Statement, not a negligently prepared tax return. The only negligence committed with respect to the tax return was the failure to file the Form 7004.

[6] At trial, the burden will be on the Bank to establish the applicable standard of care; but on a motion to dismiss, the defendant cannot claim that it did not act negligently without explaining what the applicable standard of care actually is.

claim. Rather, the court's discussion of the merits was merely within the context of defendants' argument that the claim is subject to the $7,000 damages limit in Parente's May 2, 2010 engagement letter (which is not an issue raised on the instant motion). *See id.* at 6-8. The sole ground on which the court dismissed the negligence claim (without prejudice and with leave to replead) was for failure to plead damages, a defect that, as noted, has been cured. *See id.* at 8-9.[7]

For these reasons, the court rejects defendants' argument that Parente did not act negligently without prejudice to them reasserting the argument at the summary judgment stage, provided the argument is supported with relevant legal authority and expert testimony.

The third cause of action, however, is not viable. As noted by this court in the Prior Decision, the Shareholder Plaintiffs must demonstrate near privity and the requisite linking conduct under the three prong standard set forth in *Credit Alliance Corp. v Arthur Andersen & Co.*, 65 NY2d 536 (1985). That standard requires that "(1) the accountants must have been aware that the financial reports were to be used for a particular purpose or purposes; (2) in the furtherance of which a known party or parties was intended to rely; and (3) there must have been some conduct on the part of the accountants linking them to that party or parties, which evinces the accountants' understanding of that party or parties' reliance." *See* Prior Decision at 10-11, quoting *Credit Alliance*, 65 NY2d at 551. This court also noted that the First Department has held that a firm performing a service for a corporation's board of directors with the knowledge that such service might incidentally benefit the company's investors does not constitute the

[7] One wonders whether the AC's second cause of action for the allegedly negligently prepared Financial Statement is effectively duplicative (and perhaps entirely rises and falls with the viability of) the first cause of action for negligently failing to file the Form 7004 (a claim which, as noted, defendants do not seek to dismiss). The damages the Bank suffered as a consequence of the Form 7004 not being filed might include the Financial Statement being inaccurate. The court will not make any ruling on this issue (i.e., whether the damages sought on the second cause of action are recoverable even if Parente is not found to have been negligent in preparing it) because the scope of damages is not an issue raised by the parties on this motion.

requisite linking conduct. *See id.* at 11, citing *CRT Investments, Ltd. v Merkin,* 29 Misc3d 1218(A), at *12-13 (Sup Ct, NY County 2010) (collecting cases discussing linking conduct), *aff'd sub nom. CRT Investments, Ltd. v BDO Seidman, LLP,* 85 AD3d 470, 472 (1st Dept 2011) ("The fact that plaintiffs were entitled to and received a copy of the audited financial statements, or that [the auditor] knew that the investors would rely upon the information contained in the financial statements, does not establish the requisite linking conduct"); *see also Prime Plus Acquisition Corp. v Eisneramper LLP*, 2015 WL 8490460, at *7 (Sup Ct, NY County 2015) ("plaintiffs cannot establish linking conduct based on [the accountant] providing Oak Rock's board and members ... with copies of the audit reports.").

The court then explained:

> Here, the Shareholder Plaintiffs claim the requisite linking conduct is present based on their allegations that Parente knew the Financial Statement was going to be included in the Offering Circular and would be considered by the Shareholder Plaintiffs in connection with the PRO. The Shareholder Plaintiffs further allege that the Financial Statement was provided directly to them, albeit in their capacity as board members, not shareholders. The Shareholder Plaintiffs argue this distinction does not matter since the Bank, unlike a large, publicly traded company, only has a discreet set of shareholders. Parente disagrees, arguing the claim is insufficiently pleaded.
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> Although the complaint alleges that the Financial Statement was provided to the Shareholder Plaintiffs, as Parente correctly avers, the complaint does not clearly set forth Parente's involvement with the PRO. As with the preparation of the Financial Statement, the complaint does not explain Parente's role with respect to the PRO or the timing of the events. Certainly, the Bank, its board and its shareholders are privy to this information. The complaint merely alleges that the failure to file the Form 7004 was further compounded when the assumption of the validity of the Tax Benefit was built into the Shareholder Plaintiffs' evaluation of the Bank's share price through its review of the Financial Statement contained in the Offering Circular. As alleged, the complaint fails to plead a malpractice claim based on near privity. Leave is granted to the Shareholder Plaintiffs to properly replead.

Prior Decision at 11-12.

The AC has not cured these pleading deficiencies. The only new facts proffered on this issue are that Parente, on behalf of the Bank, reviewed a proposed escrow agreement and stock offer form that would be used in the PRO. The Shareholder Plaintiffs do not plead any facts suggesting that Parente was engaged to perform this service for the Shareholder Plaintiffs, as opposed to the Bank. *See CRT*, 85 AD3d at 472 ("BDO Seidman's work in the course of the audit was performed pursuant to professional standards applicable in the context of any audit, and was not undertaken pursuant to any specific duty owed to plaintiffs. Therefore, plaintiffs cannot establish the direct nexus necessary to give them a claim against BDO Seidman for negligent misrepresentation.") (internal citation omitted), citing *Houbigant, Inc. v Deloitte & Touche LLP*, 303 AD2d 92, 94 (1st Dept 2003) ("The requisite linking was not established by Houbigant's entitlement under the terms of the license to receive a copy of RCI's audited financial statement, by Deloitte's consent to RCI forwarding a copy of the financial statements to Houbigant, or by Deloitte's knowledge that Houbigant would rely upon the information contained in the financial statements."). Indeed, like the May 2, 2011 engagement letter, the June 17, 2010 engagement letter (Dkt. 49), which governs Parente's audit services (and which was not submitted on the prior motion), makes clear that the services performed by Parente were only for the benefit of the Bank.

Whether all of the Bank's services are governed by the engagement letters in the record is not dispositive. What matters is that the Shareholder Plaintiffs have not alleged facts permitting at least a reasonable inference that Parente performed services specifically for the benefit of the Shareholder Plaintiffs, as opposed to performing services for the Bank. The cited case law makes clear that it is of no moment that, by virtue of the Bank's board members' status as shareholders, Parente's services would inherently benefit them. The Shareholder Plaintiffs cite

no case in which an accountant who performed services for a corporation and its board was held to engage in linking conduct with the shareholders because members of the board, who were also shareholders, also happened to benefit from such services. To the contrary, cases such as *CRT* and *Houbigant* make clear that non-clients incidentally benefitting from a service performed for the board does not constitute linking conduct.

White v Guarente, 43 NY2d 356 (1977), on which the Shareholder Plaintiffs rely and which predates *Credit Alliance*, does not mandate a different result. *White* involved a partnership, not a corporation. The facts in *White* are easily distinguishable because, there, the parties specifically contemplated that the limited partners would rely on the audit in preparing their tax returns. *See id.* at 361. No comparable facts are pleaded here. *White* caveated its holding by explaining that "this plaintiff seeks redress, not as a mere member of the public, but as one of a settled and particularized class among the members of which the report would be circulated for the specific purpose of fulfilling the limited partnership agreed upon arrangement." *See id.* at 363. *CRT* and *Houbigant* strongly suggest that a shareholder is not similarly situated to the limited partners in *White* when all the accountant does is perform services specifically for the benefit of the board, from which the shareholders incidentally benefit. Additionally, the First Department, in a decision affirmed by the Court of Appeals, has suggested that *White* may have been abrogated by *Credit Alliance* and, in any event, is inapplicable outside of the context of limited partners relying on a partnership audit to prepare their tax returns. *See Parrott v Coopers & Lybrand, L.L.P.*, 263 AD2d 316, 323-24 (1st Dept 2000), *aff'd* 95 NY2d 479 (2000); *see also GSP Fin. LLC v KPMG LLP*, 146 AD3d 454, 455 (1st Dept 2017) ("We note that ... [*White*] was 'supersed[ed]'" by *Credit Alliance*."; and holding that "[t]he fact that defendant's Debt

Compliance Letters, which were addressed to Hicks Sports Group LLC, were intended for the use of plaintiff (among others) does not constitute linking conduct.").

As defendants argue, *White* is inapplicable because the Shareholder plaintiffs "(1) are not partners or limited partners in a partnership or limited partnership context; (2) did not require the Financial Statement[] to prepare their own tax returns; and (3) were not requesting the services of [Parente] to fulfill any 'agreed upon arrangement' between the Shareholder Plaintiffs." *See* Dkt. 45 at 9. Parente's conduct here does not fall within the relatively narrow circumstances in which a non-client may sue an accountant for negligence. *See Sec. Pac. Bus. Credit, Inc. v Peat Marwick Main & Co.*, 79 NY2d 695, 708 (1992) (explaining that "the duty to noncontractual third parties is defined narrowly" and therefore the Court "declined to adopt the broad-brush transformation of the liability formula espoused by the dissenting opinion, because such an extension of liability to noncontracting parties is 'unwise as a matter of policy.'"). The Shareholder Plaintiffs' negligent misrepresentation claim is dismissed. Accordingly, it is

ORDERED that the motion to dismiss the amended complaint by defendants ParenteBeard LLC and Baker Tilly Virchow Krause, LLP is granted to the extent of dismissing the third cause of action with prejudice and striking the attorneys' fee demand, and the motion is otherwise denied; and it is further

ORDERED that defendants shall file an answer to the amended complaint within three weeks of entry of this order on NYSCEF; and it is further

ORDERED that the parties are to appear in Part 54, Supreme Court, New York County, 60 Centre Street, Room 228, for a status conference on June 14, 2017 at 11:30 am.

Dated: May 10, 2017

ENTER:

J.S.C.

SHIRLEY WERNER KORNREICH
J.S.C