

To be Argued by:  
J. ANDREW HEATON

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**New York Supreme Court**  
**Appellate Division—First Department**

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THEO BULLMORE and PHILLIP S. STENGER, as Joint Official Liquidators  
of BEACON HILL MASTER LTD. (In Official Liquidation),

*Plaintiffs-Appellants/Cross-Respondents,*

– against –

ERNST & YOUNG CAYMAN ISLANDS,

*Defendant-Respondent/Cross-Appellant,*

–and–

ERNST & YOUNG LLP, BEACON HILL ASSET MANAGEMENT, LLC,  
JOHN D. BARRY, THOMAS DANIELS, JOHN IRWIN, MARK  
MISZKIEWICZ, and ATC FUND SERVICES (CAYMAN) LIMITED  
f/k/a ATC FUND ADMINISTRATORS (CAYMAN) LIMITED,

*Defendants-Respondents.*

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**BRIEF FOR DEFENDANT-RESPONDENT ERNST & YOUNG LLP**

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**SUPREME COURT OF THE STATE OF NEW YORK  
APPELLATE DIVISION: FIRST DEPARTMENT**

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THEO BULLMORE and PHILLIP S. STENGER, as Joint Official Liquidators of  
BEACON HILL MASTER LTD. (In Official Liquidation),

*Plaintiffs-Appellants/Cross-Respondents,*

—against—

ERNST & YOUNG CAYMAN ISLANDS,

*Defendant-Respondent/Cross-Appellant,*

ERNST & YOUNG LLP, BEACON HILL ASSET MANAGEMENT, LLC, JOHN D. BARRY,  
THOMAS DANIELS, JOHN IRWIN, MARK MISZKIEWICZ, and ATC FUND SERVICES  
(CAYMAN) LIMITED f/k/a ATC FUND ADMINISTRATORS (CAYMAN) LIMITED,

*Defendants-Respondents.*

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**BRIEF FOR DEFENDANT-RESPONDENT ERNST & YOUNG LLP**

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**PRELIMINARY STATEMENT**

In this case, the liquidators (“Plaintiffs”) of a Cayman Islands hedge fund known as Beacon Hill Master Ltd. (the “Master Fund” or “Fund”) are seeking to recover from the Fund’s investment manager, Beacon Hill Asset Management (“Beacon Hill”), for losses suffered on investments made by the Fund at Beacon Hill’s direction. As is typical in this type of case, Plaintiffs have also sued various people and entities who provided services to the Fund: its investment manager, Beacon Hill; certain individuals who directed Beacon Hill’s operations (“Individual Defendants”); the Fund’s administrator, ATC; and its independent auditor,

Ernst & Young Cayman Islands (“E&Y Cayman”), a general partnership organized under Cayman Islands law.

Plaintiffs also asserted a claim against another entity, Ernst & Young LLP (“EYLLP”). EYLLP is a U.S. accounting firm, organized as a limited liability partnership in Delaware. It is an entirely separate partnership from E&Y Cayman. The two firms each participate in a global network branded “Ernst & Young,” but they are organized differently and have no partners in common. Plaintiffs do not allege, and could not properly allege, that the two partnerships are alter egos or otherwise responsible for each other’s obligations. In fact, they expressly disclaim any such contention. *See* Brief for Plaintiffs-Respondents (“Pl. Br.”) at 41 n.10.

EYLLP stands in a distinctly different category from the other defendants. Plaintiffs do not allege that the Master Fund ever hired EYLLP to perform an audit or any other service. Nor do they claim that EYLLP ever reported on the Fund’s financial statements or provided any information to the Fund. To the contrary, their Complaint alleges that *E&Y Cayman* was hired to be the Fund’s auditor, and that *E&Y Cayman*, not EYLLP, issued the report on which they base their claim.

What, then, is the basis of the claim against EYLLP? After careful consideration, the IAS Court (Ramos, J.) concluded that there *is* no basis for such a claim in the Complaint. Accordingly, the Court dismissed EYLLP from the case.

Plaintiffs now seek reversal of the IAS Court’s decision. They argue here, as they did below, that they have pleaded a proper negligence claim against EYLLP even though it is undisputed that EYLLP was not hired to perform an

audit, issued no audit report, and provided no information whatsoever to the Fund. Unfortunately for Plaintiffs, their contention finds no support in New York law.

An essential requirement for a negligence claim against an accounting firm in New York is that the plaintiff must allege facts establishing contractual privity, or its functional equivalent, between plaintiff and accountant. The Complaint here contains no such facts. To the contrary, the Complaint makes it unmistakably clear that *E&Y Cayman*, not EYLLP, was the firm that entered into a contract with the Master Fund, provided the audit report to the Master Fund, and therefore stood in privity with the Master Fund. In contrast, there is no allegation in the Complaint that EYLLP ever had any agreement with the Master Fund or ever made any representation on which the Fund could have relied. The absence of any such allegation is fatal. The scant assertions on which Plaintiffs rest their hopes — that EYLLP assisted with the audit work in certain respects and had various ties with investment manager Beacon Hill — have no bearing on the key issue of privity and are simply irrelevant.

Given the allegations (and absence of allegations) in the Complaint, the IAS Court correctly held that Plaintiffs' cause of action for professional negligence would lie, if at all, against *E&Y Cayman*, and not against EYLLP. The Court also correctly held that Plaintiffs' only other cause of action against EYLLP, for aiding and abetting a breach of fiduciary duty, was also deficient. Accordingly, the IAS Court properly dismissed EYLLP from the case.

## **COUNTERSTATEMENT OF QUESTIONS PRESENTED**

1. Does a complaint state a proper claim for audit malpractice against an accounting firm where the complaint makes clear that (A) a different firm, not the firm being sued, was engaged to perform the audit in question, (B) that other firm, not the firm being sued, issued the report at the conclusion of the audit, and (C) the plaintiff never received, much less relied upon, any representation from the firm being sued?

The IAS Court correctly answered this question in the negative.

2. Does a complaint state a proper claim against an accounting firm for aiding and abetting a breach of fiduciary duty by management of an entity, where the complaint does not allege that the accounting firm knew about, or substantially assisted in, any alleged breach of fiduciary duty?

The IAS Court did not reach this question, but correctly dismissed the aiding and abetting claim against EYLLP on other grounds.

## COUNTERSTATEMENT OF FACTS

### **Beacon Hill, the Master Fund, and the Alleged Fraud**

Defendant Beacon Hill was an investment manager of hedge funds. R. 72, 80: Compl. ¶¶ 1, 18.<sup>1</sup> In 1997, Beacon Hill launched two hedge funds known as Bristol and Safe Harbor. R. 80: Compl. ¶¶ 19-20. The next year, it added a fund called Milestone to its portfolio. R. 81: Compl. ¶ 21. In January 2002, Beacon Hill essentially combined Bristol, Safe Harbor and Milestone through a “feeder fund” structure to create the Master Fund. R. 81: Compl. ¶ 22.

The Master Fund invested primarily in mortgage-backed securities and U.S. Treasury bonds. R. 9-10, 14: Compl. ¶¶ 18-22, 31. Plaintiffs contend that Beacon Hill covered up losses in the Fund’s portfolio by misrepresenting the value of these investments. R. 85-86: Compl. ¶¶ 31-33. Among other things, Plaintiffs contend that the Individual Defendants used a faulty proprietary model to value the portfolio, and then “cherry picked” third-party valuations from a variety of sources to match the results generated by the model. R. 84-88, 98-99: Compl. ¶¶ 29-39, 62-64. Plaintiffs suggest that this method was used to make the Master Fund’s investments look better than they actually were, thereby concealing losses in the portfolio. *But see* pp. 9-11, *infra* (SEC alleged that Beacon Hill used “cherry picking” to *decrease*, not increase, reported investment values during the relevant period).

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<sup>1</sup> “R.,” “Compl.,” and “Op.” refer to the Joint Record, Plaintiffs’ Complaint, and the IAS Court’s Opinion in this case respectively.

## The Master Fund Audit by E&Y Cayman

Prior to the creation of the Master Fund, E&Y Cayman served as the auditor of the Bristol and Safe Harbor funds (which were organized in the Cayman Islands), and EYLLP, the separate U.S. firm, audited Milestone (which was organized in the United States). R. 90: Compl. ¶ 42. After the Master Fund was set up as a Cayman entity, E&Y Cayman was engaged to perform an audit of the Fund's financial statements as of March 31, 2002. R. 90: Compl. ¶ 43. This was the only audit of the Fund's financials ever performed, and it is the audit that Plaintiffs claim was performed improperly. R. 73-74: Compl. ¶ 3.

The Complaint expressly acknowledges that E&Y Cayman, and not EYLLP, was engaged to perform the Master Fund audit, and that E&Y Cayman, not EYLLP, issued a report to the Fund at the end of that audit. In particular, the Complaint states:

- “Pursuant to an engagement letter dated April 17, 2002, the Master Fund retained *E&Y Cayman* to audit and report on its financial statements for the period ending March 31, 2002.” R. 90: Compl. ¶ 43 (emphasis added).
- “In the Master Fund's engagement letter, *E&Y Cayman* expressly committed to conduct the audit in accordance with ‘auditing standards generally accepted in the United States of America.’” R. 91: Compl. ¶ 45 (emphasis added).
- Pursuant to the engagement letter, “the *Cayman firm* issued a ‘clean’ audit report attesting to the fair presentation of the Master Fund's financial statements in conformity with GAAP.” *Id.* (emphasis added).

In contrast, the Complaint contains no similar allegations about EYLLP. Specifically, the Complaint does not allege that EYLLP was a party to E&Y Cayman's engagement letter with the Master Fund, entered into any other engagement letter with the Fund, agreed with the Fund to provide any particular services, issued any audit report on the Fund's financial statements, or made any other representation to the Fund. EYLLP's name appears nowhere in the E&Y Cayman engagement letter or the audit report.<sup>2</sup>

### **The Purported Role of EYLLP**

The Complaint contains three main allegations concerning EYLLP's purported role. First, the Complaint alleges that EYLLP provided services to Beacon Hill and to certain other funds for which Beacon Hill served as investment manager (though not to the Master Fund). R. 90: Compl. ¶ 42. Second, it alleges that an EYLLP partner was responsible for the overall Ernst & Young relationship with Beacon Hill and was described by one of the Individual Defendants as "the Ernst & Young partner" on the Beacon Hill account. R. 90-91: Compl. ¶ 44. Finally, the Complaint alleges that a "junior, inexperienced accountant" at EYLLP assisted with the Master Fund audit by obtaining third-party prices for the securities held by the Fund, comparing those prices to valuations provided by Beacon Hill, and forwarding the result to E&Y Cayman. R. 96, 99-100, 101-114, 117-118: Compl. ¶¶

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<sup>2</sup> See R. 141-152. These documents, which are referred to, quoted, and relied upon in the Complaint, were properly before the IAS Court on EYLLP's motion to dismiss. See CPLR 3211(a)(1); see also *Pullman Group, L.L.C. v. Prudential Ins. Co. of Am.*, 288 A.D.2d 2, 2, 733 N.Y.S.2d 1, 2 (1st Dep't 2001) (affirming dismissal based on "the allegations of the complaint and the contents of the documents referenced therein").

59, 65-66, 70-103, 113; *see also* R. 82: Compl. ¶ 24. Plaintiffs characterize this task as “[taking] the lead” in confirming the valuations, although they acknowledge that it took “no more than 10 hours.” R. 99, 117-118: Compl. ¶¶ 65, 113.

This third allegation, concerning the confirmation of prices, forms the basis of Plaintiffs’ claim that EYLLP was negligent. Plaintiffs allege that EYLLP took on this work, but then failed to take steps to uncover the Beacon Hill fraud. In particular, they claim that EYLLP “allowed a junior accounting employee who was insufficiently experienced to value the securities in the Master Fund’s portfolio,” and therefore “never received a complete understanding of the value of the Master Fund’s portfolio.” *See* R. 97, 100, 102, 117–118: Compl. ¶¶ 61, 67, 71, 73, 113.

Notwithstanding these allegations concerning EYLLP, Plaintiffs essentially concede that E&Y Cayman, not EYLLP, was “ultimately responsible for the audit.” *See* R. 99–100: Compl. ¶ 66 (EYLLP’s junior accountant was “the only accountant charged by E&Y LLP with corroborating the value of securities in the Master Fund”); R. 100-101: Compl. ¶ 69 (“those ultimately responsible for the audit failed to adequately review” the junior accountant’s work); R. 91: Compl. ¶ 46 (“E&Y Cayman committed to perform the audit in accordance with [professional standards]”); R. 100: Compl. ¶ 67 (faulting the junior accountant for “fail[ing] to follow the internal guidelines drafted by E&Y Cayman”).

### **The Collapse of the Fund**

After the period covered by the audit, Beacon Hill shifted the Master Fund’s investment strategy, in effect placing a massive bet that interest rates would rise. Instead, they continued to fall, allegedly resulting in “massive trading losses.” R.

75: Compl. ¶ 5. In addition, Beacon Hill orchestrated a series of self-interested trades between the Master Fund and separate Beacon Hill-managed accounts, which allegedly resulted in further losses. R. 128–29: Compl. ¶¶ 164-166. The Complaint does not allege that EYLLP (or E&Y Cayman, for that matter) had anything to do with these post-audit investment decisions by Beacon Hill.

In October 2002, Beacon Hill disclosed that the Master Fund had suffered large losses in the previous month. This disclosure prompted an investigation by the U.S. Securities and Exchange Commission and, subsequently, the filing of a lawsuit in the Southern District of New York by the SEC against Beacon Hill and the Individual Defendants. In mid-November 2002, as a result of the SEC action, Beacon Hill consented to an order requiring the appointment of a new investment manager. Shortly thereafter, the Fund was placed into liquidation by order of a Cayman Islands court, and Plaintiffs were appointed as joint liquidators.

### **The Investor Litigation**

In April 2003, a group of investors filed an action, also in the Southern District, against Beacon Hill and others, seeking to recover for losses suffered as investors in the Master Fund’s “feeder funds.” In June 2004, the investors added EYLLP and E&Y Cayman as defendants in connection with the feeder fund audits each had performed in 2001. *See* p. 6, *supra* (E&Y Cayman audited Cayman-based funds, while EYLLP audited U.S.-based Milestone). No claims were asserted with respect to the 2002 Master Fund audit at issue here.

The investors' complaint relied extensively on the SEC's lawsuit.<sup>3</sup> Notably, one of the SEC contentions cited by the investors makes clear that with respect to the Master Fund audit at issue here, Beacon Hill's alleged "cherry-picking" was directed not at inflating the portfolio, but rather at *reducing* the prices obtained from third parties to bring them into line with the *lower* values generated by Beacon Hill's model. In other words, according to the SEC, at the time of the Master Fund audit the Funds' investments were actually worth *more*, not less, than the "cherry picked" prices indicated:

For March 2002, when the annual audit was done, Beacon Hill obtained multiple dealer prices . . . and then deliberately selected individual prices that, in aggregate, allowed Beacon Hill to match the portfolio value generated by its own internal valuation method . . . . *For March 2002, the third party prices [originally selected] initially created a total market value for the Master Fund's portfolio that was \$8.454 million higher than the market value generated by Beacon Hill's internal valuations.* In each subsequent selection, [a Beacon Hill manager] chose different third party prices to narrow the aggregate market value difference between the third party prices he selected and Beacon Hill's internal prices. . . . The final, carefully selected, prices were submitted to Beacon Hill's outside auditor . . . ."

R. 168-169: SEC Compl. ¶ 46 (emphasis added), *quoted in part in* Investors Compl. ¶ 51). *See also* Compl. ¶ 70 (same paragraph quoted in the Complaint here).

In an order dated July 5, 2005, the federal court dismissed all of the investors' claims against EYLLP and E&Y Cayman. R. 763-765. Just as the SEC had found that the Master Fund's investments were not overstated in March 2002 (and,

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<sup>3</sup> *See, e.g.,* Amended Compl. ¶¶ 48-51, *Alteram v. Beacon Hill Asset Mgmt. LLC*, No. 03-CV-2387 (S.D.N.Y. April 8, 2003).

if anything, were *understated* as of that time), the federal court concluded that the facts alleged did not support an inference that the investments managed by Beacon Hill were overvalued during the 2001 feeder fund audits, or at any time before April 2002. The court stated:

The defendants' hedge funds "involved non-exchange listed securities, the valuation of which may differ depending on the model used in the calculations." In other words, valuation of such securities was not a matter of looking up closing prices in the Wall Street Journal, but involved the exercise of judgment. The Complaint does not allege with particularity that the models used or the judgments made by [plaintiffs' sources] were superior to those used or made by Beacon Hill or other independent parties. Nor do plaintiffs allege with particularity that the alleged differences in valuations were outside the range of what is considered normal in the industry.

R. 780: Op. at 15 (citation omitted).<sup>4</sup>

#### **The Present Lawsuit and Dismissal of Claims Against EYLLP**

Plaintiffs filed this lawsuit on March 29, 2005 against E&Y Cayman, ATC, Beacon Hill, the Individual Defendants, and EYLLP. Against EYLLP, the Complaint set forth two causes of action: professional negligence, and aiding and abetting a breach of fiduciary duty. R. 115-118, 119-120: Compl. ¶¶ 108-116, 118-124. All defendants moved to dismiss.

On April 12, 2006, the IAS Court issued an opinion granting the motions to dismiss in part and denying them in part. R. 17-69. In its opinion, which runs 53

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<sup>4</sup> With respect to the period starting in April 2002 (*i.e.*, after the period covered by the financial statements at issue here), the court found that the investors' allegations could support an inference that the Fund's investments were overvalued. The court focused on a striking increase in the difference between Beacon Hill's valuations and those of its broker, as well as allegations of self-dealing by the Individual Defendants during this period. R. 781-782: Op. at 15-17.

pages, the Court carefully distinguished among the numerous defendants and causes of action, upholding some claims and dismissing others. In the end, some or all of the causes of action against E&Y Cayman, Beacon Hill, and three of the Individual Defendants remained in the case. With respect to the remaining defendants, including EYLLP, the Court dismissed the Complaint in its entirety.

In concluding that the claims against EYLLP should be dismissed, the IAS Court made the following key points:

*No Contractual Relationship.* First, the IAS Court found that EYLLP could not be liable based on a contractual relationship between accountant and client, because the Complaint did not allege any such contract or indeed any agreement for EYLLP to provide any service at all. The Complaint clearly alleged that “the Master Fund retained *E&Y Cayman* to conduct an audit.” R. 56: Op. at 40 (emphasis added). In contrast, it was equally clear from the Complaint that “no contractual relationship was ever established between the Master Fund and E&Y LLP for the performance of accounting services.” *Id.* EYLLP never “executed any agreement to perform auditing services” and was not “contractually bound” to conduct an audit. *Id.* at 38-40.<sup>5</sup>

*No Representation.* Even though there was no contractual privity between the Master Fund and EYLLP, the IAS Court recognized that a claim could still lie against EYLLP if the Complaint properly alleged a functionally equivalent relationship satisfying the criteria established by the Court of Appeals in *Credit Alli-*

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<sup>5</sup> Plaintiffs contend that the IAS Court “improperly emphasized the absence of a separate formal engagement of E&Y LLP” (Pl. Br. at 6), but that is not correct: the Court found that there was *no agreement at all*, formal or otherwise. *See* R. 55: Op. at 39.

*ance Corp. v. Arthur Andersen*, 65 N.Y.2d 536, 483 N.E.2d 110, 493 N.Y.S.2d 435 (1985). R. 55: Op. at 39. However, the Court noted that “the threshold inquiry” under *Credit Alliance* “is the accountant’s preparation of a financial report that is later relied upon by the plaintiff.” R. 57: Op. at 41. Here, it was “indisputable that EYLLP did not issue the audited financial report;” rather, “plaintiffs themselves allege that it was E&Y Cayman and not EYLLP” that issued the report.” R. 58, 57: Op. at 42, 41. Nor did the Complaint allege any other “referable, tangible representations” by EYLLP. R. 58: Op. at 42. As the Court summarized:

[I]t is a plaintiff’s reliance on the professional’s tangible work product containing representations, made pursuant to a contract with another, that triggers the three-pronged *Credit Alliance* inquiry into whether a duty to act with due care should be imposed upon the professional by law in the absence of an agreement. \* \* \* Here, E&Y LLP did not issue any financial statement, audit, report, certificate or any other tangible work product that plaintiffs allege was relied upon by the Master Fund or that came into possession of the Master Fund.

R. 58-59: Op. at 42-43 (emphasis added). Because the Complaint alleged no representation at all by EYLLP, the Court found that *Credit Alliance* did not apply. R. 59: Op. at 43.<sup>6</sup>

*No Facts Establishing Privity or Its Equivalent.* The IAS Court found Plaintiffs’ allegations concerning EYLLP’s assistance with the audit and its contacts with Beacon Hill insufficient to establish either contractual privity or its functional equivalent. R. 55: Op. at 39. It noted specifically that “EYLLP’s executive

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<sup>6</sup> The Court did not, as Plaintiffs contend, focus on the lack of a “formal document” (Pl. Br. at 6): the Court’s point was that EYLLP did not make any statement about the Fund that could have been relied upon by the Fund.

“pitching the firm’s services to Beacon Hill and its funds . . . is insufficient to establish any links approaching a relationship of privity between the Master Fund and E&Y LLP.” R. 61: Op. at 45. And critically, although one EYLLP “junior accountant” may have provided some assistance with the audit, this did not mean that EYLLP was responsible for the audit. As the Court noted, the Complaint contained “no allegation that E&Y LLP made any decision as to how the audit should be conducted and what information should be included in the report.” *Id.*

*No Basis for Aiding and Abetting Claim.* Finally, the IAS Court also dismissed the separate cause of action against EYLLP for aiding and abetting a breach of fiduciary duty by the Individual Defendants. R. 63: Op. at 47. EYLLP had sought dismissal of this count because the Complaint did not properly allege that EYLLP had “actual knowledge” of a breach of duty or provide “substantial assistance” in connection with such a breach, as required by this Court. However, the IAS Court did not reach that ground, relying instead on its dismissal of the underlying breach of fiduciary duty claim. R. 62-63: Op. at 46-47 (“As the court dismissed the primary breach of fiduciary claim . . . no claim for aiding and abetting the breach of such duty can lie.”).

## ARGUMENT

### I. THE IAS COURT CORRECTLY DISMISSED THE CLAIM AGAINST EYLLP FOR PROFESSIONAL NEGLIGENCE

To state a claim for professional negligence against an accountant, a plaintiff must properly allege, among other things, that the accountant owed the plaintiff a duty of care. In New York, there are two ways that a plaintiff can allege such a duty. The first is to allege the existence of contractual privity, *e.g.*, that the plaintiff hired the accountant to perform an audit and issue an opinion. The second option is to allege a bond “so closely approximating privity that it [is], in practical effect, virtually indistinguishable therefrom” under the framework set forth by the Court of Appeals in *Credit Alliance*, 65 N.Y.2d at 545-546, 483 N.E.2d at 114, 493 N.Y.S.2d at 439. To establish this “functional equivalent of contractual privity,” *Ossining Union Free Sch. Dist. v. Anderson LaRocca Anderson*, 73 N.Y.2d 417, 419, 539 N.E.2d 91, 91, 541 N.Y.S.2d 335, 335 (1989), the plaintiff must allege that the accountant made a representation on which the plaintiff relied, as well as specific facts satisfying the three-prong *Credit Alliance* test. *See Parrott v. Coopers & Lybrand L.L.P.*, 95 N.Y.2d 479, 483, 741 N.E.2d 506, 508, 718 N.Y.S.2d 709, 711 (2000) (plaintiff must make “a showing that there was either actual privity of contract . . . or a relationship so close as to approach that of privity”).

In this case, the IAS Court correctly determined that Plaintiffs had failed to state a claim under either method. With respect to contractual privity, the Court found that the Complaint did not allege that EYLLP was hired to be the Master Fund’s auditor, or indeed to provide any services to the Fund. To the contrary, the

Complaint makes clear that it was E&Y Cayman, not EYLLP, that the Fund had hired. As for the “functional equivalent of privity” the Court found the Complaint to be equally deficient. Notably, the Complaint does not allege that EYLLP issued an audit report or made any other statement about the Fund. Accordingly, the Complaint does not even satisfy the threshold requirement of an alleged representation, much less allege facts satisfying the three-prong *Credit Alliance* test. Nor could it satisfy this requirement: the Complaint itself makes clear that it was E&Y Cayman, and not EYLLP, that issued the audit report.

Given the absence of these crucial allegations, the IAS Court properly dismissed the professional negligence claim against EYLLP.

**A. The Complaint Does Not Allege Contractual Privity Between The Master Fund And EYLLP; Rather, The Complaint Makes Clear That The Fund Hired E&Y Cayman, Not EYLLP, As Its Auditor**

The first method by which a plaintiff may state a claim for professional negligence against an accountant is to allege the existence of contractual privity — *i.e.*, that there was a relevant contractual relationship between the plaintiff and the accountant governing the services at issue. As the IAS Court recognized, the Complaint does not allege any such relationship.

It is hornbook law that for a contractual relationship to exist, there must be a meeting of the minds between the parties on specific contract terms. *Express Indus. & Terminal Corp. v. New York State Dep’t of Transp.*, 93 N.Y.2d 584, 589, 715 N.E.2d 1050, 1053 (1999) (“there must be a manifestation of mutual assent sufficiently definite to assure that the parties are truly in agreement with respect to

all material terms”).<sup>7</sup> The Complaint here does not come close to satisfying this basic requirement. It says nothing about any meeting of the minds between EYLLP and the Master Fund, nor does it allege any specific terms on which these parties might have agreed. Specifically, there is no allegation that EYLLP ever agreed to perform an audit, or any other services, for the Master Fund. There is no allegation that the Master Fund ever *asked* EYLLP to perform any services. There is no allegation that EYLLP and the Master Fund ever even *discussed* the provision of services. Indeed, there is no allegation that EYLLP and the Master Fund ever had any discussion of any sort about anything.<sup>8</sup>

To be sure, the Complaint does allege the existence of a contract, and a written one at that. But that contract is between the Master Fund and *E&Y Cayman*, not EYLLP. As noted above, the Complaint alleges that:

- *E&Y Cayman* was retained by the Master Fund to audit and report on its financial statements. R. 90: Compl. ¶ 43.
- *E&Y Cayman* expressly committed to conduct the audit in accordance with professional standards. R. 91: Compl. ¶ 45.
- *E&Y Cayman* issued a report on the Master Fund’s financial statements. *Id.*

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<sup>7</sup> New York law also requires that a contract be supported by consideration. *Suthers v. Amgen Inc.*, 372 F. Supp. 2d 416, 423 (S.D.N.Y. 2005) (citing *Furia v. Furia*, 116 A.D.2d 694, 695, 498 N.Y.S.2d 12, 13 (2d Dep’t 1986)). There is no allegation in the Complaint that EYLLP received any consideration in connection with the Master Fund audit.

<sup>8</sup> Although the required agreement can be implicit, an implied-in-fact contract still requires “proof of meeting of the minds.” *I.G. Second Generation Partners, L.P. v. Duane Reade*, 17 A.D.3d 206, 208, 793 N.Y.S.2d 379, 382 (1st Dep’t 2005).

The Complaint is devoid of any similar allegations concerning EYLLP. There is simply nothing in the Complaint to suggest that EYLLP agreed to provide audit services, or *any* services, to the Master Fund.

New York courts have repeatedly held that an accountant cannot be held liable based on alleged failure to perform, or negligent performance of, services that the accountant did not agree to perform. For instance, in *Italia Imports, Inc. v. Weisberg & Lesk*, 220 A.D.2d 226, 631 N.Y.S.2d 363 (1st Dep't 1995), the plaintiff sued the defendant accounting firm for failing to discover an embezzlement by one of the plaintiff's employees. This Court affirmed the trial court's dismissal of the complaint, noting that the "unambiguous written engagement letter" provided that "the accounting firm would merely perform an annual compilation of Imports' financial records . . . without verification by the accounting firm." *Id.* at 226, 631 N.Y.S.2d at 364. Accordingly, there was "no agreement to perform a 'review' or an 'audit' of [the company's] financial condition." *Id.* This Court held that "[u]nder these circumstances, it is clear that the accountants are not liable for failing to discover the defalcations of the bookkeeper." *Id.*; accord *Zupnick v. Thompson Parking Partners, Ltd.*, No. 89 CIV 6607, 1990 U.S. Dist. LEXIS, at \*28-29 (S.D.N.Y. Aug. 1, 1990) (accounting firm not liable for not conducting audit procedures where firm's "engagement was limited to the preparation of a compilation report"); see also *William Iselin & Co. v. Mann Judd Landau*, 71 N.Y.2d 420, 424-425, 522 N.E.2d 21, 22-23, 527 N.Y.S.2d 176, 177-178 (1988) (noting key differences between the limited "review report" prepared by defendant accounting firm and a "traditional certified audit").

These holdings make good sense because the nature of an accountant's duties may vary significantly from one engagement to another. An audit, for instance, is a complex and detailed engagement involving numerous substantive and analytical procedures, conducted in accordance with established principles. On the other hand, an accountant may be engaged to perform a limited "review," conduct a customized set of "agreed-upon procedures," or simply provide specific advice on a narrow issue. Each type of work involves different duties and presents different risks for the accountant. Given this wide range of potential services, it would be inappropriate to allow a plaintiff to pursue a claim where, as here, the complaint does not reflect any agreement for the accountant to provide the specific services at issue. *See Zupnick*, 1990 U.S. Dist. LEXIS, at \*28 (where accountant has agreed only to provide compilation services, requiring "a more thorough investigation . . . would constitute a court-ordered modification of the limited nature of [the] engagement and, in effect, a transformation of the compilation report" into a full audit).

Here, Plaintiffs are not merely attempting to expand the contours of an existing engagement, as in *Zupnick* or *Italia Imports*: they are seeking to create an agreement between the Master Fund and EYLLP from whole cloth. The Complaint does not allege that the Master Fund engaged EYLLP to do *anything*, much less perform an audit. Plaintiffs should not be permitted unilaterally to impose significant liability on EYLLP as if (contrary to fact) EYLLP had agreed to assume the responsibilities and risks of undertaking an audit, particularly on the basis of nothing more than a few hours of work by a junior accountant. Given that an

accountant cannot be held liable to an actual client for services falling outside its engagement, it certainly cannot be held liable to an *alleged* client to whom it has agreed to provide no services whatsoever.

**B. The Complaint Does Not Allege Facts Establishing The Functional Equivalent Of Contractual Privity Under *Credit Alliance***

Because the Complaint does not allege contractual privity between EYLLP and the Master Fund, Plaintiffs' only hope for stating a negligence claim against EYLLP under New York law would be to establish a relationship amounting to the functional equivalent of privity under *Credit Alliance*. Unfortunately for Plaintiffs, their Complaint falls well short of the mark in this regard as well.

In *Credit Alliance*, the Court of Appeals set forth a framework for determining when a plaintiff who has allegedly relied on an accountant's report, but who is not in contractual privity with the accountant, may pursue a claim against the accountant for professional negligence. The Court held that the plaintiff, in addition to establishing reliance on the accountant's report, must plead and prove a relationship "so close as to approach that of privity" under a three-prong test:

- (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.

65 N.Y.2d at 551-552, 483 N.E.2d at 118-119, 493 N.Y.S.2d at 443-444. To avoid dismissal, the complaint must satisfy all three prongs of the test. “As with a three-legged table, remove one prop, and the entire structure must fall.” *Parrott v. Coopers & Lybrand L.L.P.*, 263 A.D.2d 316, 320-321, 702 N.Y.S.2d 40, 44 (1st Dep’t), *aff’d*, 95 N.Y.2d 479, 741 N.E.2d 506, 718 N.Y.S.2d 709 (2000).

**1. The Complaint Does Not Satisfy The Threshold Requirement Of An Alleged Representation By EYLLP**

As an initial matter, the *Credit Alliance* test does not even apply here because Plaintiffs have not alleged, and could not allege, that EYLLP issued an audit report or made any other representation on which Plaintiffs could have relied.

*Credit Alliance* itself makes clear that the issuance of a report by the defendant accountant — or at least the making of *some* representation by the accountant — is necessary before the three-prong test can even be applied. *See* 65 N.Y.2d at 550-551, 483 N.E.2d at 117-118, 493 N.Y.S.2d at 442-443 (noting that the issue at hand was whether accountants owed a duty to parties not in contractual privity “to make [*their reports*] without negligence”) (emphasis added; brackets in original) (quoting *Ultramares Corp. v. Touche*, 255 N.Y. 170, 179, 74 N.E. 441, 444 (1931)). Cases following *Credit Alliance* confirm that the existence of a report that was transmitted to and relied upon by the plaintiff is central to the analysis. *See, e.g., IFD Constr. Corp. v. Corddry Carpenter Dietz & Zack*, 253 A.D.2d 89, 93, 685 N.Y.S.2d 670, 672 (1st Dep’t 1999) (cause of action against professional by a non-client accrues only when allegedly defective work product is received by the plaintiff, “since that is the earliest date on which the injured party, who did not

retain the professional, could have relied upon it”); *Lampert v. Mahoney, Cohen & Co.*, 218 A.D.2d 580, 581, 630 N.Y.S.2d 733, 734 (1st Dep’t 1995) (functional equivalent of privity not alleged because “[a]bsent in this case is any allegation that plaintiff ever saw any financial reports, let alone relied on them”); *Ernest Lawrence Group v. Marketing the Americas, Inc.*, No. 03 Civ. 1510 (PKC), 2005 U.S. Dist. LEXIS 25307, at \*36 (S.D.N.Y. Oct. 26, 2005) (no functional equivalent of privity where accounting firm “was not asked to prepare nor did in fact prepare any reports, formal or informal,” for plaintiffs).

Here, there is no allegation that EYLLP made any representation or furnished anything, let alone an audit report, to the Master Fund. Accordingly, *Credit Alliance* cannot support Plaintiffs’ negligence claim against EYLLP.

## **2. The Complaint Fails The *Credit Alliance* Three-Prong Test**

Even if *Credit Alliance* could apply here — which, as explained above, it cannot — Plaintiffs would still fail to state a claim for negligence against EYLLP because the allegations in the Complaint do not satisfy the three-prong test established in that case. Failing even one of the three prongs is fatal. *Parrott*, 263 A.D.2d at 320, 702 N.Y.S.2d at 44. Here, the Complaint fails all three.

*Knowledge That Its Report Would Be Used For A Particular Purpose.* The first *Credit Alliance* requirement is that the accountant must have been aware that its “financial reports were to be used for a particular purpose.” 65 N.Y.2d at 551, 483 N.E.2d at 118, 493 N.Y.S.2d at 443. But EYLLP did not issue any financial report, nor did it provide any other information to the Master Fund. As this Court has noted, “it seems axiomatic that for defendant accountants to ‘have been aware

that the financial reports were to be used for a particular purpose . . . ' it must have prepared financial reports that a third party could rely upon." *Lampert*, 218 A.D.2d at 582, 630 N.Y.S.2d at 735 (ordering complaint dismissed where defendant did not provide any report to plaintiff).

Plaintiffs try to finesse the issue by arguing that EYLLP knew how *E&Y Cayman's* audit report would be used. But the focus under *Credit Alliance* is properly on the accountant's *own* work, not the work of some other firm. And EYLLP could not have been "aware" that its *own* work would be used by the Master Fund *at all*, much less for a "particular purpose." EYLLP's work product was provided only to E&Y Cayman. It was up to that firm to decide how to use EYLLP's assistance in conducting its audit and preparing its report. *Cf. In re AM Int'l Inc. Sec. Litig.*, 606 F. Supp. 600, 607 (S.D.N.Y. 1985) (foreign affiliates of U.S. accounting firm that had acted as sources of information for U.S. firm's audit were not liable for fraud, because there were "no facts alleged . . . which remotely suggest that the foreign firms ever participated in the decision as to how this information should be reported").

*Intended Reliance On Its Report By A Known Party.* The second prong of *Credit Alliance* requires that the accountant intended to cause the plaintiff to rely on the accountant's report. 65 N.Y.2d at 551, 483 N.E.2d at 118, 493 N.Y.S.2d at 443. Again, since EYLLP did not issue any report or provide any other information to the Fund, this prong has not been, and cannot be, satisfied. The only representation that the Master Fund could possibly have relied upon was the report issued by E&Y Cayman. And the Fund, by virtue of the engagement letter and the

report, was aware (and agreed) that only E&Y Cayman was engaged to perform the audit, and that only E&Y Cayman issued the report.

In *Securities Investor Protection Corp. v. BDO Seidman, L.L.P.*, 95 N.Y.2d 702, 746 N.E.2d 1042, 723 N.Y.S.2d 750 (2001), plaintiff SIPC — an entity that insures brokerage accounts — sued an insolvent broker’s auditor. SIPC had not received any report from the auditor, but asserted that it had a claim because the auditor knew that the broker was required to submit audited financial statements to the National Association of Securities Dealers, which in turn was required to relay any negative information to SIPC. *Id.* at 708-09, 746 N.E.2d at 1046-47, 723 N.Y.S.2d at 754-55. Thus, SIPC argued, it had relied on the auditor’s work indirectly. The Court of Appeals rejected this argument. It found that because NASD was the party responsible for determining what, if any, information would be relayed to SIPC, SIPC did not (and could not, as a matter of law) rely on any statement or omission by the auditor. “The omission on which SIPC claims reliance . . . did not come from [the auditor], it came from NASD.” *Id.* at 710, 746 N.E.2d at 1047, 723 N.Y.S.2d at 755. “[T]he reporting system on which SIPC relied put too much discretion in the hands of the NASD for SIPC to be able to claim any significant direct reliance” on the auditor. *Id.*

*BDO Seidman* is directly on point here. Based on the undisputed documents incorporated in the Complaint, it is beyond doubt that E&Y Cayman was the party hired to issue (and responsible for) the Master Fund’s audit report, and therefore had control over the content and preparation of that report — including how to use the information EYLLP provided. There is no allegation to the contrary in the

Complaint. Just as NASD's discretion precluded any claim of reliance on the auditor in *BDO Seidman*, so does E&Y Cayman's discretion over how to use the assistance afforded by EYLLP preclude the Master Fund's claim in this case.

Linking Conduct. Finally, the third prong of *Credit Alliance* requires an allegation of conduct that links the auditor to the plaintiff and "evinces the accountants' understanding of that party or parties' reliance." 65 N.Y.2d at 551, 483 N.E.2d at 118, 493 N.Y.S.2d at 443. No such conduct is alleged here. There is no allegation that EYLLP provided any work product to the Master Fund — or, in fact, that EYLLP had any substantive communication with the Fund whatsoever. The absence of any such communication, let alone a report from EYLLP, is fatal. See *Security Pacific Bus. Credit, Inc. v. Peat Marwick Main & Co.*, 79 N.Y.2d 695, 705, 597 N.E.2d 1080, 1085, 586 N.Y.S.2d 87, 92 (1992) (telephone call to plaintiff was not sufficient communication to constitute linking conduct); *LaSalle Nat'l Bank v. Ernst & Young LLP*, 285 A.D.2d 101, 107-108, 729 N.Y.S.2d 671, 675-676 (1st Dep't 2001) (same).<sup>9</sup>

### **C. Plaintiffs' Allegations Concerning EYLLP's Role Cannot Save Their Negligence Claim**

Plaintiffs' arguments in support of their negligence claim against EYLLP really comes down to the notion that certain alleged contacts between EYLLP and its co-defendant Beacon Hill are enough to establish privity, or at least the funct-

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<sup>9</sup> Compare *Credit Alliance*, 65 N.Y.2d at 545-546, 483 N.E.2d at 114, 493 N.Y.S.2d at 439 (linking conduct allegations sufficient where there were multiple, direct and substantive communications and personal meetings with plaintiff); *Ossining*, 73 N.Y.2d at 425-426, 539 N.E.2d at 95, 541 N.Y.S.2d at 339 (linking conduct allegations sufficient where plaintiff school district expressly authorized defendants' retention, defendants billed the district directly, and defendants acknowledged in writing that they were "hired by the school district").

ional equivalent of privity, between EYLLP and the Master Fund. *See* p. 14, *supra* (discussing alleged contacts). This is not the case.

At the most basic level, the notion that alleged contacts with *Beacon Hill* can establish the requisite connection with the *Master Fund* is inconsistent with the Complaint. The fact that Plaintiffs, acting on behalf of the Master Fund, brought suit against Beacon Hill (R. 72, 77: Compl. ¶¶ 1, 11) suggests that Plaintiffs do not view the two entities as alter egos. Indeed, the Complaint expressly alleges that the Master Fund was not a tool of Beacon Hill, but rather was governed by “independent directors with no other ties to Beacon Hill.” R. 81: Compl. ¶ 22.<sup>10</sup> But in any case, regardless of whether contacts with Beacon Hill are as good as contacts with the Master Fund itself, the particular contacts alleged here are of no help to Plaintiffs. As the IAS Court recognized, none of them has any bearing on the requirement of privity.

*Other Engagements.* The negligence claim against EYLLP in this case is based on one specific audit: the audit of the financial statements of the Master Fund for the period ended March 31, 2002. R. 73: Compl. ¶ 3. *This* is the engagement for which Plaintiffs must establish privity or its functional equivalent. The allegation that EYLLP audited other financial statements for other Beacon Hill entities at other times (R. 82: Compl. ¶¶ 24, 42) says nothing about the parties’

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<sup>10</sup> This allegation will no doubt be disputed if this case proceeds to trial, but for purposes of this appeal, it must be taken as true. *See Williams & Co. v. Collins Tuttle & Co.*, 6 A.D.2d 302, 304, 176 N.Y.S.2d 99, 101 (1st Dep’t 1958) (“The allegations of the amended complaint are taken as true, for purposes of . . . the appeal, although it is reasonable to assume that the principal allegations . . . will be vigorously denied.”).

understanding as to *this* engagement, as to which the Master Fund entered into an express contract with a separate firm. R. 90: Compl. ¶ 43.

In *Security Pacific*, plaintiff SPBC, a commercial lender, sued accounting firm Peat Marwick, claiming that it had relied on a 1984 audit report for one of the bank's borrowers. 79 N.Y.2d at 699, 597 N.E.2d at 1081, 586 N.Y.S.2d at 88. Attempting to satisfy *Credit Alliance*, SPBC pointed to evidence that it had "contacts and discussions" with the accounting firm in the prior year concerning a line of credit for the borrower, and that one of the firm's accountants had "made assurances" to SPBC about the 1983 audit opinion. *Id.* at 707, 699, 597 N.E.2d at 1086, 1080, 586 N.Y.S.2d at 94, 88. The Court of Appeals quickly dismissed these allegations concerning 1983 activity as "irrelevant" because the claim at issue related to the accounting firm's 1984 audit. *Id.* at 699, 597 N.E.2d at 1081-1082, 586 N.Y.S.2d at 88-89. Noting the absence of any meaningful contacts concerning the 1984 engagement, the Court of Appeals concluded that "the evidence of the contacts and discussions between SPBC and [the accounting firm] with regard to the 1983 [line of credit] cannot bridge the chasm between [the parties] with respect to the 1984 audit report." *Id.* at 707, 597 N.E.2d at 1086, 586 N.Y.S.2d at 93.

*Beacon Hill Management.* The allegation that an EYLLP partner was responsible for the overall Ernst & Young relationship with Beacon Hill is of no moment. EYLLP was the auditor for Beacon Hill itself, so it would be natural and expected for an EYLLP partner to be a primary point of contact for Beacon Hill's management. Nor does the contention that this partner was described by a member of Beacon Hill's management as "the Ernst & Young partner" help Plaintiffs. A

unilateral statement by Beacon Hill cannot satisfy either the contractual privity requirement or *Credit Alliance*. See *Jane Street Co. v. Rosenberg & Estis, P.C.*, 192 A.D.2d 451, 451, 597 N.Y.S.2d 17, 18 (1st Dep't 1993) ("plaintiff's unilateral beliefs and actions do not confer upon it the status of client"); *LaSalle*, 285 A.D.2d at 107-108, 729 N.Y.S.2d at 675-676 ("affirmative conduct evincing [the accountant's] acknowledgement" required; "unilateral conduct" by plaintiffs insufficient).

*Assistance With Audit*. Finally, Plaintiffs make much of their allegation that a "junior accountant" from EYLLP, without the involvement of anyone else from the firm, assisted E&Y Cayman with the Master Fund audit for "no more than 10 hours." R. 118: Compl. ¶ 113. Once again, they are off the mark.

Although involvement by a defendant accounting firm in performing critical audit steps may be necessary to a claim against that firm, it is irrelevant to the privity requirement. Contractual privity, or its counterpart under *Credit Alliance*, depends not on the nature or extent of the work performed, but rather on the existence of an agreement between the parties, or at least a demonstrated common understanding that is the functional equivalent of an agreement. The mere fact that EYLLP provided a few hours of assistance with the audit cannot substitute for the elements of contract formation or the requirements of *Credit Alliance*.

For instance, in *Housing Works, Inc. v. Turner*, 179 F. Supp. 2d 177 (S.D.N.Y. 2001), an accountant had performed an audit of plaintiff Housing Works' records and had issued a report to a governmental body. Although it had not hired the accountant, Housing Works contended that it should be able to sue the accountant for negligence because it was "the subject of the audit." The court

squarely rejected this contention, finding the argument “creative” but “unpersuasive.” *Id.* at 104 n.38; *see also* R. 349: *Blumenfeld Dev. Group v. Roux Assocs.*, 5 Misc. 3d 1015A, 798 N.Y.S.2d 707, slip op. (N.Y. Sup. Ct. Sept. 28, 2004) (claim against environmental consultant dismissed where consultant had performed engagement and prepared report on property owned by plaintiff, but had been retained by another party and not by plaintiff); *Common Fund for Non-Profit Orgs. v. KPMG Peat Marwick LLP*, 951 F. Supp. 498, 501 (S.D.N.Y. 1997) (*Credit Alliance* not satisfied although accountant had performed part of the audit on plaintiff’s premises).

In the end, Plaintiffs are left with nothing that would support a finding of contractual privity or satisfy *Credit Alliance*. Accordingly, the IAS Court’s dismissal of the negligence claim against EYLLP should be affirmed.

## **II. THE IAS COURT CORRECTLY DISMISSED THE CLAIM AGAINST EYLLP FOR AIDING AND ABETTING A BREACH OF FIDUCIARY DUTY**

Like their negligence claim, Plaintiffs’ claim for aiding and abetting a breach of fiduciary duty was properly dismissed.

To state a claim for aiding and abetting a breach of fiduciary duty, a plaintiff must allege the existence of a primary breach, knowledge of that breach on the part of the aider and abettor, and substantial assistance by the aider and abettor in causing the breach. *See Kaufman v. Cohen*, 307 A.D.2d 113, 124-126, 760 N.Y.S.2d 157, 169-170, 629-630 (1st Dep’t 2003). Here, the IAS Court dismissed the claim against EYLLP for failure to satisfy the first of these requirements. The required primary breach was embodied in Plaintiffs’ claim against the Individual Defen-

dants for breach of a fiduciary duty owed to the Fund. Because the Court dismissed this primary cause of action, it also dismissed the related claim against EYLLP. See R. 61-63: Op. at 45-47 (dismissing claim on the ground that it did not allege facts going beyond ordinary breach of contract; citing, *inter alia*, *Perl v. Smith Barney Inc.*, 230 A.D.2d 664, 666 (1st Dep't 1996)).

Although the IAS Court did not need to reach the issue, dismissal of the aiding-and-abetting claim was also appropriate because Plaintiffs failed to satisfy the “knowledge” and “substantial assistance” requirements as well.

This Court has consistently held that constructive knowledge is not sufficient to satisfy the knowledge requirement. Rather, the plaintiff must plead facts indicating that the alleged aider and abettor had actual knowledge of the primary wrong. *Kaufman*, 307 A.D.2d at 125, 760 N.Y.S.2d at 169 (“there must be an allegation that [the] defendant had actual knowledge of the breach of duty”); *Ascot Fund Ltd. v. UBS PaineWebber, Inc.*, 28 A.D.3d 313, 314, 814 N.Y.S.2d 36, 37 (1st Dep't 2006) (affirming dismissal where complaint failed to allege “any facts or conduct” indicating actual knowledge); *accord Brasseur v. Speranza*, 21 A.D.3d 297, 299, 800 N.Y.S.2d 669, 671 (1st Dep't 2005) (“bare allegations” that defendant “knew or should have known” were insufficient).

Similarly, absent a fiduciary relationship, mere inaction or failure to detect a fraud will not suffice to allege substantial assistance. Rather, the plaintiff must allege an affirmative act in furtherance of the fraud. *Kaufman*, 307 A.D.2d at 126, 760 N.Y.S.2d at 170; *see also Brasseur*, 21 A.D.3d at 299, 800 N.Y.S.2d at 671

(general allegation that breach could not have been accomplished “without the complicity” of defendant was insufficient).

As EYLLP first noted in the IAS Court, the Complaint here does not adequately allege either actual knowledge or substantial assistance. With regard to the knowledge requirement, Plaintiffs specifically allege that EYLLP “allowed a junior accounting employee who was insufficiently experienced to value the securities in the Master Fund’s portfolio” and therefore “never received a complete understanding of the value of the Master Fund’s portfolio.” *See* R. 97, 100, 102, 117, 118, Compl. at ¶¶ 61, 67, 71, 73, 113. In other words, Plaintiffs contend that EYLLP did not understand that the portfolio was overvalued — and therefore failed to detect the alleged fraud. Such conduct may (if true) allege negligence, but it falls far short of the required “actual knowledge.” *See Kaufman*, 307 A.D.2d at 126, 760 N.Y.S.2d at 170 (affirming dismissal of aiding-and-abetting claim where allegations would only support a finding of constructive notice, not actual knowledge).<sup>11</sup>

As for substantial assistance, the Complaint is equally deficient. All the Complaint alleges is that EYLLP failed to corroborate Beacon Hill’s valuation

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<sup>11</sup> Particularly given that the Complaint acknowledges that EYLLP did not detect (and thus had no actual knowledge of) the underlying fraud, Plaintiffs’s boilerplate allegation that EYLLP “knew [of], or was willfully blind” to Beacon Hill’s conduct (Compl. ¶ 122) is of no consequence. *See* p. 30, *supra* (conclusory allegations of knowledge insufficient).

Moreover, even assuming that “willful blindness” could satisfy the requirement of actual knowledge, nothing in the Complaint would support a conclusion that EYLLP was willfully blind to (*i.e.*, consciously avoided learning about) any breach of fiduciary duty. *See Fraternity Fund Ltd. v. Beacon Hill Asset Mgmt.*, No. 03 Civ. 2387, 2007 U.S. Dist. LEXIS 31107, at \*56 (S.D.N.Y. March 27, 2006) (conscious avoidance occurs only when “‘it can almost be said that the defendant *actually knew*’ because he or she suspected a fact and realized its probability, but refrained from confirming it in order later to be able to deny knowledge”).

method or properly verify the value of the Master Fund's investments. Compl. ¶ 121. But in a case like this one, where the alleged aider and abetter did not itself owe a fiduciary duty,<sup>12</sup> New York law requires an *affirmative act*, not just a failure to act. See *Kaufman*, 307 A.D.2d at 126, 760 N.Y.S.2d at 170 (allegation that defendant failed to disclose a breach of duty was insufficient); R. 358: *Levin v. PricewaterhouseCoopers LLP*, Index No. 110886/00 (Sup. Ct. N.Y. County Nov. 21, 2001) (allegation that the defendant "ignored or permitted the alleged breaches . . . falls short of the required 'substantial assistance'" (unpublished opinion), *aff'd*, 302 A.D.2d 287, 754 N.Y.S.2d 541 (1st Dep't 2003).

In the IAS Court, Plaintiffs relied on *Houbigant, Inc. v. Deloitte & Touche, LLP*, 303 A.D.2d 92, 753 N.Y.S.2d 493 (1st Dep't 2003). *Houbigant* involved a claim of aiding and abetting a fraud, not a breach of fiduciary duty. *Id.* at 100, 753 N.Y.S.2d at 500. In that case, moreover, plaintiff had alleged facts suggesting that the accountant *actually knew* of the precise conditions that ultimately led to the insolvency of its client, yet still rendered a "knowingly false" audit report. *Id.* at 95-97 (citing, *inter alia*, a "private letter by Deloitte to [the client's] audit committee" reporting "deficiencies and problems" that Deloitte knew about, but did not mention in the audit report). Here, there are no facts alleged that would indicate

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<sup>12</sup> No fiduciary relationship is alleged between EYLLP and the Master Fund. Moreover, such a relationship would be inconsistent with the allegation that EYLLP acted as an auditor for the Fund, because the independent role of auditor is incompatible with the role of a fiduciary. See *TSG Water Resources, Inc. v. D'Alba & Donovan CPAs*, 366 F. Supp. 2d 1212, 1227 (S.D. Ga. 2004) (citing *Franklin Supply Co. v. Tolman*, 454 F.2d 1059, 1065 (9th Cir. 1991)) and other cases); see also *Friedman v. Anderson*, 23 A.D.3d 163, 193, 803 N.Y.S.2d 514, 516 (1st Dep't 2005) ("Generally, there is no fiduciary relationship between an accountant and his client").

that EYLLP actually knew about Beacon Hill's fraud. Nor is there a claim that EYLLP issued *any* audit report, let alone a "knowingly false" one.

Thus, Plaintiffs' aiding-and-abetting claim fails not only the threshold requirement of an underlying breach, as the IAS Court found, but all three requirements for such a claim. The claim was properly dismissed.

## CONCLUSION

For the foregoing reasons, the judgment of the IAS Court dismissing the Complaint as against E&Y LLP should be affirmed.

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Respectfully submitted,

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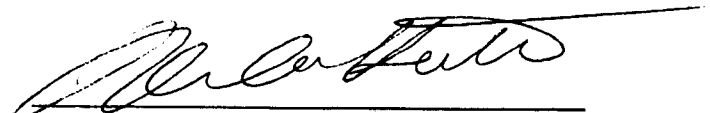
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