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UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF WASHINGTON

METROPOLITAN MORTGAGE & SECURITIES CO., INC. and SUMMIT SECURITIES, INC., Plaintiffs, v. PRICEWATERHOUSECOOPERS, LLP, Defendant.	Case No. CV-05-0290-FVS APPENDIX OF UNPUBLISHED AUTHORITIES IN SUPPORT OF DEFENDANT PRICEWATERHOUSECOOPERS LLP'S MOTION TO DISMISS

APPENDIX OF UNPUBLISHED AUTHORITIES

Tab

CASES:

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Tab 1

2 of 2 DOCUMENTS

In re: AGRIBIOTECH, INC., Debtor. ANTHONY H.N. SCHNELLING, as Trustee of the Agribiotech Creditors' Trust, the Duly Appointed and Authorized Representative of the Chapter 11 Estates of AGRIBIOTECH INC., et al., as Assignee of Growers, Plaintiff, v. JOHNNY R. THOMAS, et al., Defendants.

CV-S-02-0537-PMP (LRL)

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEVADA

2005 U.S. Dist. LEXIS 6465

March 2, 2005, Decided
March 4, 2005, Filed

SUBSEQUENT HISTORY: Summary judgment granted by, Dismissed by, in part, Motion to strike denied by, Motion denied by *Schneilling v. Thomas (In re AgriBioTech, Inc.), 2005 U.S. Dist. LEXIS 6466 (D. Nev., Apr. 1, 2005)*

PRIOR HISTORY: [*1] BK-S-00-10533-LBR, ADV-02-1023-LBR *Schnelling v. Thomas (In re AgriBioTech, Inc.), 2005 U.S. Dist. LEXIS 6467 (D. Nev., Mar. 2, 2005)*

CASE SUMMARY:

PROCEDURAL POSTURE: Pursuant to a debtor's Chapter 11 proceeding, plaintiff, a trustee for the creditors' trust, brought an action against defendant accounting firm, claiming professional negligence, participation in a breach of duty, actual and constructive fraud, and aiding and abetting fraud. The firm brought a motion for summary judgment. The trustee filed a response with exhibits, and the firm brought a motion to strike one of the trustee's exhibits.

OVERVIEW: The trustee's exhibit was a one-page unsigned document appearing to be notes taken from the debtor's computer system from a meeting between the debtor's chief financial officer (CFO) and a member of the firm. The CFO did not recall the document or a conference with a member of the firm. The firm moved to strike the exhibit as hearsay. The court agreed that the notes were offered to prove the truth of the matter asserted in the notes and that the trustee failed to show a nonhearsay purpose or any hearsay exception. The notes did not fit the business record exception under *Fed. R. Evid. 803(6)* because there was no showing that the meeting notes were made as part of a regularly conducted business activity. They did not come within past recollection recorded under Rule 803(5) because there was no evidence establishing that the CFO's notes accurately reflected his knowledge at the time. Further, the notes were not a statement against interest under *Fed. R. Evid. 804(b)(3)* because the CFO did not remember the exhibit or the meeting and it was not against the CFO's interest at the time to admit that restatement of the debtor's financial information would be disastrous.

OUTCOME: The court granted the firm's motion to strike the trustee's summary judgment exhibit.

LexisNexis(R) Headnotes

Civil Procedure > Trials > Judicial Discretion
Evidence > Hearsay Rule & Exceptions > Hearsay Rule Components
Evidence > Hearsay Rule & Exceptions > Hearsay Within Hearsay

[HN1] Hearsay is a statement, other than one made by the declarant while testifying at the trial or hearing, offered in evidence to prove the truth of the matter asserted. *Fed. R. Evid. 801(C)*. Hearsay is not admissible absent an applicable exception. *Fed. R. Evid. 802*. Hearsay within hearsay is admissible so long as each link in the hearsay chain conforms to a separate hearsay exception. *Fed. R. Evid. 805*. The decision whether to admit evidence under an exception to the hearsay rule lies within the court's discretion.

Evidence > Hearsay Rule & Exceptions > Business Records

[HN2] *Fed. R. Evid. 803(6)* excludes from the hearsay rule records of regularly conducted activity. Under the Rule, a memorandum, report, record, or data compila-

tion, in any form, of acts, events, conditions, opinions, or diagnoses, made at or near the time by, or from information transmitted by, a person with knowledge, if kept in the ordinary course of a regularly conducted business activity, and if it was the regular practice of that business activity to make the memorandum, report, record or data compilation, unless the source of information or the method or circumstances of preparation indicate lack of trustworthiness. The term "business" as used in this paragraph includes business, institution, association, profession, occupation, and calling of every kind, whether or not conducted for profit. *Fed. R. Evid. 806(6).*

Evidence > Hearsay Rule & Exceptions > Business Records

[HN3] Pursuant to *Fed. R. Evid. 803(6)*, the evidence thus must be (1) made by a regularly conducted business activity, (2) kept in the regular course of that business, (3) the regular practice of that business to make the memorandum, (4) and made by a person with knowledge or from information transmitted by a person with knowledge. Additionally, the business record must be sufficiently trustworthy.

Evidence > Hearsay Rule & Exceptions > Business Records

Evidence > Hearsay Rule & Exceptions > Hearsay Within Hearsay

[HN4] The business record exception is based on the theory that accuracy and trustworthiness are assured by systematic checking, by regularity and continuity which produce habits of precision, by actual experience of business in relying upon them, or by a duty to make an accurate record as part of a continuing job or occupation. In short, businesses have incentives to keep accurate records. To ensure this accuracy, the person furnishing the information to be recorded must have been acting routinely, under a duty of accuracy, with employer reliance on the result. If the supplier of information does not act in the regular course of business, a separate hearsay exception must apply to the hearsay within hearsay statement.

Evidence > Hearsay Rule & Exceptions > Recorded Recollection

[HN5] *Fed. R. Evid. 803(5)* excludes from the hearsay rule a memorandum or record of an event where (1) the witness once had knowledge about the matters in the document, (2) the witness now has insufficient recollection to testify fully and accurately, and (3) the record was made or adopted by the witness at a time when the matter was fresh in the witness' memory and reflected the witness' knowledge correctly. If a record falls within this exception, it may be read into evidence, but it is not admissible as an exhibit unless offered by an adverse party. *Fed. R. Evid. 803(5).*

Evidence > Hearsay Rule & Exceptions > Statement Against Interest

[HN6] *Fed. R. Evid. 804(b)(3)* excludes from the hearsay rule statements against interest. Under the Rule, a statement against interest is a statement made by a declarant who is now unavailable which was at the time of its making so far contrary to the declarant's pecuniary or proprietary interest, or so far tended to subject the declarant to civil or criminal liability, or to render invalid a claim by the declarant against another, that a reasonable person in the declarant's position would not have made the statement unless believing it to be true. *Fed. R. Evid. 804(b)(3).* Accordingly, a statement is admissible under this exception if: (1) that the declarant is unavailable, (2) the statement is against the declarant's pecuniary or civil or penal interest, and (3) a reasonable person would not have made the statement unless he believed it to be true. The court must examine the statement at issue in context, to see whether as a matter of common sense the portion at issue was against interest and would not have been made by a reasonable person unless he believed it to be true. A declarant is unavailable for purposes of Rule 804 if he testifies to a lack of memory on the subject matter. *Fed. R. Evid. 804(a)(3).*

Evidence > Hearsay Rule & Exceptions > Admissions by Coconspirator

[HN7] *Fed. R. Evid. 801(d)(2)(E)* defines as nonhearsay a statement offered against a party that is a statement by a coconspirator of the party during the course and in furtherance of the conspiracy. To be "in furtherance," the statement must advance a common objective of the conspiracy or set in motion a transaction that is an integral part of the conspiracy. To determine whether a statement was in furtherance, the court looks to the declarant's intent, not the statement's actual effect.

Evidence > Hearsay Rule & Exceptions > Residual Exception

[HN8] Hearsay not otherwise falling with an exception in *Fed. R. Evid. 803* or *804* still may be admissible under the residual or "catch-all" hearsay exception in *Fed. R. Evid. 807*. Hearsay evidence sought to be admitted under Rule 807 must have circumstantial guarantees of trustworthiness equivalent to the listed exceptions to the hearsay rule. Additionally, the evidence must be of a material fact; must be more probative on the point for which it is offered than any other evidence which the proponent can procure through reasonable efforts; and admission of the evidence must serve the interests of justice. *Fed. R. Evid. 807.*

Civil Procedure > Summary Judgment > Burdens of Production & Proof

[HN9] On summary judgment, a party need not present evidence in a form admissible at trial because at this stage, courts focus on the admissibility of the evidence's contents rather than on its form.

Evidence > Hearsay Rule & Exceptions > Hearsay Rule Components

[HN10] Hearsay evidence offered for purposes other than to prove the truth of the matter asserted is admissible for the limited nonhearsay purpose for which it is offered. Such evidence does not require a hearsay exception to be admissible.

COUNSEL: For Las Vegas Fertilizer Co., Inc., Schnelling, Anthony H.N., Agribiotech Inc., Garden West Distributors, Inc., Geo. W. Hill & Co., Inc., Plaintiffs: Candi Carlyon, Shea & Carlyon, Ltd., Las Vegas, NV; Allan Diamond, M. Bryant, Diamond McCarthy Taylor Finley Bryant & Lee, LLP, Dallas, TX; Arley Finley, III, C. Carr, Scott DeWolf, Diamond McCarthy, et al, Austin, TX; Donald Campbell, Donald F. Campbell, Dallas, TX; Eric Madden, Diamond McCarthy, et al, Dallas, TX; Jay Madrid, Talmage Boston, Winstead Sechrest & Minick, PC, Dallas, TX.

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For Annas Jonathan, Defendant: Thomas Fell, Gordon & Silver, Ltd., Las Vegas, NV.

For Baines, Harrison M. Jr., Defendant: Jeffrey Silvestri, John Laxague, McDonald Carano Wilson, Las Vegas, NV; Hal Shaftel, Louis Solomon, Michael Smith, Proskauer Rose, New York, NY.

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son, James Kremer, Joseph Hammel, Micahel Iwan, Roy Ginsburg, Dorsey & Whitney, Minneapolis, MN; Daniel Quesnel, PRO HAC VICE FIRM, Winston-Salen, NC; William K. Davis, Winston-Salem, NC; Doug Fisher, Austin, TX.

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For Schnelling, Anthony H.N., Trustee: Candi Carlyon, Shea & Carlyon, Ltd., Las Vegas, NV; Allan Diamond, M. Bryant, Diamond McCarthy Taylor Finley Bryant & Lee, LLP, Dallas, TX; Arley Finley, III, C. Carr, Diamond McCarthy, et al, Austin, TX; Deborah Williamson, Cox & Smith, Inc., San Antonio, TX; Donald F. Campbell, Dallas, TX; Eric Madden, Diamond McCarthy, et al, Dallas, TX; Jay Madrid, Winstead Sechrest & Minick, PC; Dallas, [*5] TX; Scott DeWolf, Diamond McCarthy, et al, Dallas, TX; Talmage Boston, Winstead Sechrest & Minick, PC, Dallas, TX.

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For Thomas, Johnny R., Defendant: Joseph Kistler, William Noall, Gordon & Silver, Las Vegas, NV; Andrew Jacobson, Ross Bricker, Jenner & Block, LLC, Chicago, IL.

For Womble Carlyle Sandridge & Rice PLLC, Defendant: Patrick Byrne, Snell & Wilmer, Las Vegas, NV; Russell Stowers, Snell & Wilmer, Tuscon, AZ; William, Raper, Womble Carlyle, et al, Charlotte, NC.

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For Orr, L. Glenn Jr., Defendant: Richard Holley, Santoro Driggs Walch Kearney, et al, Las Vegas, NV; Alan Ruley, PRO HAC VICE FIRM, Bell Davis Pitt, PA, Winston-Salem, NC; Daniel Quesnel, PRO HAC VICE FIRM, Winston-Salen, NC; William K. Davis, Winston-Salem, NC.

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For KPMG Peat Marwick LLP, Cross Defendant: Michael Rawlins, Rooker Rawlins & Bailey, LLP, Henderson, NV; Cheryl Mori-Atkinson, U.S. Securities & Exchange Commission, Saly Lake City, UT; Gary Bendinger, Karen Martinez, Bendinger, Crockett Peterson & Casey, Salt Lake City, UT; Richard Casey, Bendinger, Crocket Peterson & Casey, Salt Lake City, UT.

For KPMG Peat Marwick LLP, Defendant: C. Rooker, Michael Rawlins, Rooker Rawlins & Bailey, LLP, Henderson, NV; Cheryl Mori-Atkinson, U.S. Securities & Exchange Commission, Saly Lake City, UT; Gary Bendinger, Karen Martinez, Marcia Fuller, R. Saber, Richard Casey, Wesley Felix, Bendinger, [*8] Crockett Peterson & Casey, Salt Lake City, UT.

JUDGES: PHILIP M. PRO, Chief United States District Judge.

OPINIONBY: PHILIP M. PRO

OPINION:

ORDER

Presently before the Court is KPMG LLP's Motion to Strike Trustee's Summary Judgment Exhibit 33 (Doc. #742), filed on September 13, 2004. Plaintiff Anthony H. N. Schnelling filed the Trustee's Response to KPMG LLP's Motion to Strike Trustee's Summary Judgment Exhibit 33 (Doc. #764) on October 28, 2004. Defendant KPMG LLP ("KPMG") filed its Reply (Doc. #780) on December 9, 2004.

I. BACKGROUND

AgriBioTech, Inc. ("AgriBioTech" or"ABT") originally was founded in 1983. (Third Am. Compl. (Doc. #328) P 51.) As of 1998, AgriBioTech was the largest forage and turfgrass seed producer in the United States. (Id. P 1.) "On January 25, 2000, ABT and three of its subsidiaries, L[as] V[egas] F[ertilizer Co.], Garden West [Distributors,] and [Geo. W.] Hill [& Co., Inc.] commenced jointly administered Chapter 11 cases by filing voluntary petitions under Chapter 11 of the United States Bankruptcy Code . . . ." (Id. P 12.) The Debtors created a Creditors' Trust pursuant to the First Amended Joint Plan of Reorganization ("Reorganization [*9] Plan" or "Plan"), which United States Bankruptcy Judge Linda B. Riegle confirmed. (Id.; Trustee's Resp. to KPMG LLP's Mot. for Summ. J. on All Claims Purportedly Brought by Trustee on Behalf of Non-Debtor Third Parties, Ex. B.)

Plaintiff Anthony H. N. Schnelling ("Trustee"), as Trustee of the AgriBioTech Creditors' Trust, brought this lawsuit against certain former AgriBioTech professionals based on the rights assigned him pursuant to the Plan. (First Am. Compl. (Doc. #438) PP 1, 7.) The Trustee asserts against KPMG claims for professional negligence (count 8), participation in breach of fiduciary duty (count 9), actual and constructive fraud (count 16), and aiding and abetting actual and constructive fraud (count 18). (Third Am. Compl. PP 351-387, 393-97, 403-09.)

On July 20, 2004, KPMG filed a Motion for Summary Judgment (Imputation, In Pari Delicto, and Causation-Damages). (Doc. #691.) The Trustee filed its Response on August 13, 2004. (Doc. #704.) The Trustee also filed two additional volumes of exhibits supporting its Response. (Doc. ##705, 706.) Among these exhibits is exhibit 33, which purports to be notes taken from the ABT computer system of a conference between ABT's [*10] Chief Financial Officer ("CFO") Henry Ingalls ("Ingalls") and Edward Trott ("Trott") from KPMG. (Trustee's Resp. to KPMG LLP's Mot. for Summ. J. (Imputation, In Pari Delicto, and Causation-Damages), Vol. III (Doc. #706), Ex. 33.)

Exhibit 33 is a one page document entitled "Trott conference," and appears to be notes from a meeting. Included within the notes are references to ABT's prior restatement of its financial information, and that such restatement was met with "very adverse reaction in [the] market." The exhibit also notes that on August 14 ABT issued a "press release saying no restatement" and that "Restatement at this time would be devistating [sic]." The document is not dated or signed.

The Trustee provides the declaration of Scott Dean ("Dean"). (Trustee's Resp. to KPMG LLP's Mot. to Strike Trustee's Summ. J. Ex. 33, Ex. C.) Dean was employed by the ABT Creditor's Trust after confirmation of the Plan. (Id. at P 2.) In that capacity, Dean became familiar with ABT's books and records. (Id. at P 4.) Dean attaches to his declaration a copy of exhibit 33 created in Microsoft Word format saved in ABT's computer system as "Trott.doc." (Id. at P 6.) Also attached [*11] to Dean's declaration are copies of information contained on ABT's computer system showing properties of the document, including when it was created and last modified. (Id. at PP 7-8.) The computer records show the document was saved in a directory entitled "Ingalls," was created on September 24, 1998, and has not since been modified. (Id., Exs. B, C.)

At his deposition, Ingalls stated exhibit 33 "vaguely looked familiar." (Trustee's Resp. to KPMG LLP's Mot. to Strike Trustee's Summ. J. Ex. 33, Ex. D at 311-12.) He stated that while working at ABT, he saved documents in the Word format. (Id. at 312-13.) The document bears a Bates stamp with "HI" as the first letters, indicating Ingalls produced the document in discovery, but he did not specifically recall producing this document. (Id. at 313.) Ingalls did not recall the document, and did not recall a conference with Trott in which he and Trott discussed the topics listed in exhibit 33. (Id. at 313-14.) Ingalls did not recall expressing to anyone the opinion that restating ABT's financial statements in 1998 would be "devastating," although he admitted that a public company never wants to restate its financial statements [*12] because of

the negative perception associated with restatements. (Id. at 315-18.)

Ingalls does not overtly admit or deny he is the author of exhibit 33. When questioned about exhibit 33's reference to restatement being devastating, Ingalls stated:

> Again, I would say, I don't remember the context under which this was put together, or for what purpose it was, or what the subject matter was at that time. It appears that I used that -- that in my background notes. I can't recall exactly what my thought process was at that time because I can't recall what the situation was.

Id. at 316-17.) At Trott's deposition, Trott stated he had never seen exhibit 33 before, and that the exhibit did not refresh his recollection as to any discussion with Ingalls on the subjects listed in the exhibit. (KPMG LLP's Mot. to Strike Trustee's Summ. J. Ex. 33, Ex. B at 56-57.)

KPMG moves to strike exhibit 33 as hearsay under *Federal Rule of Evidence 801* that does not fall within a hearsay exception. The Trustee responds that exhibit 33 falls within several exceptions to the hearsay rule, including the business records exception under *Federal Rule of Evidence 803(6)* [*13] , the statement against interest exception under *Federal Rule of Evidence 804(b)(3)*, the past recollection recorded exception under *Federal Rule of Evidence 803(5)*, and the residual exception to the hearsay rule under *Federal Rule of Evidence 807*. Additionally, the Trustee contends it can state a conspiracy claim against KPMG and that exhibit 33 thus would fall under the hearsay exception for statements made by a co-conspirator under *Federal Rule of Evidence 801(d)(2)(E)*. Finally, the Trustee contends the statements are admissible for purposes other than the truth of the matter asserted, such as to show KPMG's knowledge, motive and intent.

II. DISCUSSION

[HN1] Hearsay is "a statement, other than one made by the declarant while testifying at the trial or hearing, offered in evidence to prove the truth of the matter asserted." *Fed. R. Evid. 801(C)*. Hearsay is not admissible absent an applicable exception. *Fed. R. Evid. 802*. Hearsay within hearsay is admissible so long as "each [*14] link in the hearsay chain conforms to a separate hearsay exception." *Padilla v. Terhune, 309 F.3d 614, 621 (9th Cir. 2002)*; *Fed. R. Evid. 805*. The decision whether to admit evidence under an exception to the hearsay rule lies within this Court's discretion. *United States v. Johnson, 297 F.3d 845, 862-63 (9th Cir. 2002)*.

Exhibit 33 is hearsay because it is an out of court statement by the author of the document being offered by the Trustee to prove the truth of the matter asserted, i.e., Ingalls' statement that he and Trott had a conversation regarding restatement of ABT's financial statements in the fall of 1998. Additionally, exhibit 33 contains hearsay within hearsay, i.e., Ingalls' out of court statements to Trott that restatement would be disastrous. Accordingly, exhibit 33 is inadmissible unless each layer of hearsay falls within a hearsay exception or is relevant for non-hearsay purposes.

A. Business Records

[HN2] *Federal Rule of Evidence 803(6)* excludes from the hearsay rule records of regularly conducted activity. Under the Rule--

> A memorandum, report, record, or data compilation, [*15] in any form, of acts, events, conditions, opinions, or diagnoses, made at or near the time by, or from information transmitted by, a person with knowledge, if kept in the ordinary course of a regularly conducted business activity, and if it was the regular practice of that business activity to make the memorandum, report, record or data compilation, . . . unless the source of information or the method or circumstances of preparation indicate lack of trustworthiness. The term "business" as used in this paragraph includes business, institution, association, profession, occupation, and calling of every kind, whether or not conducted for profit.

Fed. R. Evid. 803(6). [HN3] The evidence thus must be "(1) made by a regularly conducted business activity, (2) kept in the 'regular course' of that business, (3) 'the regular practice of that business to make the memorandum,' (4) and made by a person with knowledge or from information transmitted by a person with knowledge."*Clark v. City of Los Angeles, 650 F.2d 1033, 1036-37 (9th Cir. 1981)* (quoting *Fed. R. Evid. 803(6)*). Additionally, the business record [*16] must be sufficiently trustworthy. *United States v. Olano, 62 F.3d 1180, 1206 (9th Cir. 1995)*.

[HN4] The business record exception is based on the theory that accuracy and trustworthiness are assured "by systematic checking, by regularity and continuity which produce habits of precision, by actual experience of business in relying upon them, or by a duty to make an accurate record as part of a continuing job or occupa-

tion." See Advisory Committee Note to *Rule 803(6)*. In short, "businesses have incentives to keep accurate records." *Timberlake Constr. Co. v. U.S. Fid. and Guar, Co., 71 F.3d 335, 341 (10th Cir. 1995)*. To ensure this accuracy, the person furnishing the information to be recorded must have been acting "routinely, under a duty of accuracy, with employer reliance on the result." Advisory Committee Note to *Rule 803(6)*. If the supplier of information does not act in the regular course of business, a separate hearsay exception must apply to the hearsay within hearsay statement. Id.; *United States v. Ray, 930 F.2d 1368, 1370 n.6 (9th Cir. 1990)* ("Of course, if the person providing the information in the business record is not acting under a [*17] duty of accuracy in the regular course of business, a double hearsay problem may arise.").

The Trustee has not established that exhibit 33 is a business record. Although exhibit 33 was found among ABT's records, the Trustee has not offered any evidence to show the meeting notes were made as part of a regularly conducted business activity. Assuming Ingalls is the author of the document and that it was made at or near the time of his alleged meeting with Trott, no evidence in the record establishes Ingalls regularly took notes from meetings, or that it was ABT's or Ingalls' regular practice to make such notes, or that he was under any business duty to report his notes or the events of the meeting. Exhibit 33 does not have the hallmarks of reliability that underlie the business records exception. Accordingly, the Court, in its discretion, concludes exhibit 33 does not fall within the business records exception to the hearsay rule.

B. Past Recollection Recorded

[HN5] *Federal Rule of Evidence 803(5)* excludes from the hearsay rule a memorandum or record of an event where "(1) the witness once had knowledge about the matters in the document, [*18] (2) the witness now has insufficient recollection to testify fully and accurately, and (3) the record was made or adopted by the witness at a time when the matter was fresh in the witness' memory and reflected the witness' knowledge correctly." *United States v. Collicott, 92 F.3d 973, 984 (9th Cir. 1996)*. If a record falls within this exception, it may be read into evidence, but it is not admissible as an exhibit unless offered by an adverse party. *Fed. R. Evid. 803(5)*.

The Court concludes, in its discretion, that exhibit 33 does not fall within the past recollection recorded exception. No evidence in the record establishes that Ingalls' notes accurately reflect his knowledge at the time. At his deposition, Ingalls stated he could not recall the document or the alleged meeting the document describes. Ingalls does not indicate his notes accurately reflected his knowledge at the time he made them. n1 Accordingly, exhibit 33 does not fall within the past recollection recorded exception.

n1 KPMG argues the Trustee has not established Ingalls authored exhibit 33. Ingalls never stated he authored the document, but he stated it looked vaguely familiar, and he talked about the notes as if he had written them. (Trustee's Resp. to KPMG LLP's Mot. to Strike Trustee's Summ). J. Ex. 33, Ex. D at 311-12, 316-17.)

[*19]

C. Statement Against Interest

[HN6] *Federal Rule of Evidence 804(b)(3)* excludes from the hearsay rule statements against interest. Under the Rule, a statement against interest is a statement made by a declarant who is now unavailable "which was at the time of its making so far contrary to the declarant's pecuniary or proprietary interest, or so far tended to subject the declarant to civil or criminal liability, or to render invalid a claim by the declarant against another, that a reasonable person in the declarant's position would not have made the statement unless believing it to be true." *Fed. R. Evid. 804(b)(3)*. Accordingly, a statement is admissible under this exception if: (1) that the declarant is unavailable, (2) the statement is against the declarant's pecuniary or civil or penal interest, and (3) a reasonable person would not have made the statement unless he believed it to be true. *United States v. Beydler, 120 F.3d 985, 987 (9th Cir. 1997)*. The court must examine the statement at issue "in context, to see whether as a matter of common sense the portion at issue was against interest and would [*20] not have been made by a reasonable person unless he believed it to be true." *United States v. Shryock, 342 F.3d 948, 981 (9th Cir. 2003)* (quotation omitted). A declarant is unavailable for purposes of *Rule 804* if he testifies to a lack of memory on the subject matter. *Fed. R. Evid. 804(a)(3)*.

The Court concludes, in its discretion, that exhibit 33 does not fall within the statement against interest exception. Ingalls testified he could not remember exhibit 33 or the meeting it describes, and thus Ingalls is unavailable for purposes of *Rule 804*. Ingalls' notes essentially are an out of court statement that Ingalls told Trott that restatement would be disastrous. Ingalls was CFO and a shareholder of ABT, and thus an actual restatement of ABT's financials would have affected adversely his interests because of the detrimental effect restatement would have had on ABT. But it was not against Ingalls' interests at the time he made the statement to admit that restatement would be disastrous. In other words, while

restatement might have affected Ingalls' interests, the statement itself acknowledging as much is not so far against Ingalls' interests [*21] as to fall within the exception.

D. Statement of Co-Conspirator

[HN7] *Federal Rule of Evidence 801(d)(2)(E)* defines as nonhearsay a statement offered against a party that is a statement by a coconspirator of the party during the course and in furtherance of the conspiracy. To be "in furtherance," the statement "must advance a common objective of the conspiracy or set in motion a transaction that is an integral part of the conspiracy." *United States v. Williams, 989 F.2d 1061, 1068 (9th Cir. 1993)*. To determine whether a statement was in furtherance, the court looks to the declarant's intent, not the statement's actual effect. Id.

The Court concludes, in its discretion, that exhibit 33 is not nonhearsay as a statement of a co-conspirator. The Trustee makes no argument and provides no foundational evidence of any such conspiracy in its Response. Additionally, two levels of hearsay are at issue with this memo: the initial conversation between Ingalls and Trott, and the notes reflecting that meeting. The Trustee makes no attempt to explain how Ingalls' notes documenting the alleged meeting between himself and Trott furthered the purported [*22] conspiracy. For example, the Trustee presents no evidence Ingalls disseminated the notes to others involved in the conspiracy to advise them of the meeting. Accordingly, exhibit 33 is inadmissible as a statement of a co-conspirator. n2

n2 The Trustee also argues in a footnote that exhibit 33 has independent legal significance. (Trustee's Resp. to KPMG LLP's Mot. to Strike Trustee's Summ. J. Ex. 33 at 17 n.7.) But the Trustee makes no argument explaining why exhibit 33 has independent legal significance.

E. Residual Hearsay Exception

[HN8] Hearsay not otherwise falling with an exception in *Federal Rules of Evidence 803* or *804* still may be admissible under the residual or "catch-all" hearsay exception in *Federal Rule of Evidence 807*. "Hearsay evidence sought to be admitted under *Rule 807* must have circumstantial guarantees of trustworthiness equivalent to the listed exceptions to the hearsay rule." *United States v. Sanchez-Lima 161 F.3d 545, 547 (9th Cir. 1998)*. [*23] Additionally, the evidence must be of a material fact; must be more probative on the point for which it is offered than any other evidence which the proponent can procure through reasonable efforts; and admission of the evidence must serve the interests of justice. Id.: *Fed. R. Evid. 807*.

The Court concludes, in its discretion, that exhibit 33 does not fall within the residual hearsay exception. Exhibit 33 does not have circumstantial guarantees of trustworthiness equivalent to the listed exceptions. The document is undated and unsigned. It references a conference of an undetermined date. The evidence of authorship is tenuous, and Ingalls did not overtly acknowledge the notes were his. Ingalls also did not indicate the notes accurately reflected a meeting between himself and Trott. Absent reliable evidence of authorship, timing, the circumstances under which it was prepared, or its accuracy, exhibit 33 does not possess circumstantial guarantees of trustworthiness.

F. Admissibility of Contents of Memos

[HN9] On summary judgment, a party need not present evidence in a form admissible at trial because at this stage, courts focus [*24] on the admissibility of the evidence's contents rather than on its form. *Fraser v. Goodale, 342 F.3d 1032, 1036-37 (9th Cir. 2003)*. The Trustee thus argues the contents of the memo are admissible even if the exhibit's form is not.

The Trustee does not explain how the contents of the memo will be admitted at trial. Ingalls and Trott both testified they do not recall any such meeting or discussion regarding the notes' contents, and both testified the notes did not refresh their recollection as to any such meeting. The Court already has ruled the notes do not fall within the past recollection recorded exception. Accordingly, the contents of the notes are not admissible because the Trustee cannot establish how the contents would be presented in admissible form at trial.

G. Nonhearsay Purposes

[HN10] Hearsay evidence offered for purposes other than to prove the truth of the matter asserted is admissible for the limited nonhearsay purpose for which it is offered. *United States v. Boulware, 384 F.3d 794, 806-07 (9th Cir. 2004)*. Such evidence does not require a hearsay exception to be admissible. Id.

The Trustee argues exhibit 33 is admissible for nonhearsay [*25] purposes because it shows KPMG's knowledge, motive and intent. According to the Trustee, regardless if it was true that restatement would be devastating, Ingalls told Trott it would be and thus it is relevant to determine whether KPMG did not require ABT to restate its financials due to pressure from KPMG's client. Additionally, the Trustee argues that because proximate cause is an issue on summary judgment, evidence as to what was foreseeable to KPMG in 1998 is relevant, and exhibit 33 shows KPMG was on notice as to foreseeable harm.

Exhibit 33 contains two levels of hearsay, the notes and the conversation documented in those notes. The first level of hearsay, Ingalls' statements to Trott, may show KPMG's knowledge and intent, and therefore would be admissible for nonhearsay purposes. But the Trustee offers no nonhearsay purpose for the notes themselves. The notes could not serve either of the asserted nonhearsay purposes because KPMG never saw or adopted the notes, and thus the notes could not show KPMG's knowledge or intent or put KPMG on notice regarding foreseeability. The Trustee thus is offering the notes to prove the truth of the matter asserted in those notes, i.e. that Ingalls [*26] and Trott had a conversation about restatement being disastrous. Because the Trustee has not identified a nonhearsay purpose for the notes themselves, the Court will not consider exhibit 33 for nonhearsay purposes.

III. CONCLUSION

IT IS THEREFORE ORDERED that KPMG LLP's Motion to Strike Trustee's Summary Judgment Exhibit 33 (Doc. #742) is hereby GRANTED.

DATED: March 2, 2005

PHILIP M. PRO

Chief United States District Judge

Tab 2

1 of 100 DOCUMENTS

RESOLUTION TRUST CORPORATION, a corporation, Plaintiff, v. ANTHONY AZEVEDO, DONALD ONG, ARNOLD BELLINI, JOE MATTOS, ALBANO G. OLIVEIRA, JOSEPH R. RAMOS, VINCENT RODRIGUES, ALVARINHO DE SOUSA CLEMENTINO, KEN MACHADO, EDWARD MARTINS, JAMES MARTIN, JOSE RODRIGUES, ELISEU SOUSA, MARLENE WEIBEL, PRUDENTIAL-BACHE SECURITIES, INC., UMIC, INC. and KPMG PEAT MARWICK, Defendants. AND RELATED CROSS ACTIONS.

No. C-92-1304-CAL ENE

UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA

1993 U.S. Dist. LEXIS 20233

October 4, 1993, Decided
October 4, 1993, Filed; October 7, 1993, Entered

CASE SUMMARY:

PROCEDURAL POSTURE: Defendants, brokerage and accounting firms, filed motions for summary judgment on plaintiff Resolution Trust Corporation's (RTC) complaint that alleged the brokerage firms negligently misrepresented investments, and breached fiduciary duties, to an insolvent bank, and that the accounting firm breached a contract, and its fiduciary duties to the bank regarding the bank's investments, and thereby caused the bank to suffer investment losses.

OVERVIEW: The brokerage firms, through their salesmen, sold investments to the bank. In granting the motions for summary judgment on the RTC's claim of negligent misrepresentation the court held that the bank could not have justifiably relied upon the salesmen's statements where the bank through its chief officer was sophisticated, and had rejected its consultant's advice to sell the investments. Furthermore, the court held there was no fiduciary relationship between the brokerage firms and the bank when there was no discretion given to the brokerage firms to make investments, but rather the bank decided upon and directed the brokerage firms to merely execute trades. The court granted the accounting firm's motion for summary judgment on the bank's breach of contract claim based upon its conclusion that the bank could not place liability for the investment losses on the accounting firm. The court reasoned that there was no proximate cause between the investment losses and the alleged failure by the accounting firm to advise the bank earlier as to the proper accounting treatment for the cost of the investments, which allegedly would have disclosed the bad investments.

OUTCOME: The court granted the brokerage firms' motions for summary judgment because the RTC failed to show that the bank justifiably relied upon any alleged negligently misrepresented statements, nor did the RTC prove that a fiduciary relationship existed between the brokerage firms and the bank. The court granted the accounting firm's motion for summary judgment because it never breached its contract with the bank.

LexisNexis(R) Headnotes

Torts > Business & Employment Torts > Negligent Misrepresentation

[HN1] The basic elements that the plaintiff has to prove to show negligent misrepresentation are, misrepresentation of a material fact, which also includes an omission, intent to induce reliance, ignorance of the truth by the person receiving the information, justifiable reliance, and resulting damages.

JUDGES: [*1] LEGGE

OPINIONBY: CHARLES A. LEGGE

OPINION:

ORDER GRANTING SUMMARY JUDGMENT FOR PRUDENTIAL-BACHE SECURITIES, INC.

The motion of Defendant Prudential-Bache Securities, Inc., now known as Prudential Securities, Inc. ("Prudential") for summary judgment against Plaintiff Resolution Trust Corporation ("RTC") came on regularly for hearing before this Court on September 24, 1993. Moving and responding parties were represented by counsel.

After full consideration of the moving, opposition and reply papers, as well as the evidence submitted in support thereof, and such other papers, submissions and the arguments presented by counsel at or before the hearing on this matter, and good cause appearing therefor,

IT IS HEREBY ORDERED that Prudential's motion for summary judgment on each claim alleged against it by Plaintiff RTC is GRANTED, for the reasons stated by the Court at the hearing on this matter. A copy of the Reporter's Partial Transcript of Proceedings, which memorializes those reasons, is attached to this Order as Exhibit A.

IT IS SO ORDERED.

DATED: October 4, 1993.

THE HONORABLE CHARLES A. LEGGE

UNITED STATES DISTRICT JUDGE

EXHIBIT A

IN THE UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF [*2] CALIFORNIA

BEFORE THE HONORABLE CHARLES A. LEGGE, JUDGE

RESOLUTION TRUST CORPORATION,

PLAINTIFF,

VS.

ANTHONY D. AZEVEDO, ET AL.,

DEFENDANTS.

NO. C-92-1304 CAL ENE

FRIDAY, SEPTEMBER 24, 1993

SAN FRANCISCO, CALIFORNIA

REPORTER'S PARTIAL TRANSCRIPT OF PROCEEDINGS

APPEARANCES:

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FOR DEFENDANT

PRUDENTIAL-BACHE:

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(APPEARANCES CONTINUED:)

REPORTED BY:

DIANE E. SKILLMAN,

OFFICIAL COURT REPORTER

FOR DEFENDANT

PEAT MARWICK:

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FOR DEFENDANTS

MACHADO, MATTOS & MARTIN:

ROBERT L. MEZZETTI, ESQUIRE

31 EAST JULIAN STREET

SAN JOSE, CA 95112

FRIDAY, SEPTEMBER 24, 1993

9:30 A.M.

* *

THE COURT: ALL RIGHT WE ARE HERE FOR THE MOTIONS TO DIMISS OF UMIC, PRUDENTIAL AND PEAT MARWICK.

FIRST OF ALL, WHERE WE ARE PROCEDURALLY. [*3] IN PRETRIAL PROCEEDINGS AND IN STATUS CONFERENCES, THE MOTIONS WE SEVERED THIS CASE INTO TWO TRACKS. ONE BEING . . . DEALING WITH THE OFFICER/DIRECTOR DEFENDANTS AND THE SECOND TRACK DEALING WITH PEAT MARWICK PRU AND UMIC.

WITH RESPECT TO THE PEAT MARWICK AND PRU AND UMIC, WE SET A DEPOSITION AND DISCOVERY SCHEDULE WHICH HAS BEEN ACCOMPLISHED AND THAT DISCOVERY HAS BE DONE. SO, THE ISSUES OF SUMMARY JUDGMENT ARE NOW BEFORE ME. AND THIS CASE REQUIRES ME, OF COURSE, TO ANALYZE THAT UNDER THE STANDARD OF RULE 56, TO WIT, NO GENUINE ISSUE OF MATERIAL FACT.

SO, WHERE I MAKE STATEMENTS OF FACT IN WHAT I'M ABOUT TO SAY, IT SHOULD BE CLEAR FOR THE RECORD THAT THOSE STATEMENTS I MADE BY WHAT I BELIEVE IS NO GENUINE ISSUE OF MATERIAL FACT.

NOW I'M GOING TO TAKE UMIC'S MOTION FIRST SIMPLY BECAUSE THAT'S THE FIRST ONE I HAVE TO GO OVER.

THE PLAINTIFF ALLEGES TWO CAUSES OF ACTION AGAINST UMIC. NUMBER ONE IS NEGLIGENT MISREPRESENTATION REGARDING TREASURY STRIPS, AND SECOND, BREACH OF FIDUCIARY DUTY. I WILL DEAL, FIRST OF ALL, WITH THE ALLEGED NEGLIGENT MISREPRESENTATION. AND, OF COURSE, THOSE ALLEGED MISSTATEMENTS DEAL WITH THE SAFETY, PROFITABILITY, VOLATILITY, WHAT HAVE YOU, OF USE OF TREASURY [*4] STRIPS AS AN INVESTMENT.

I THINK EVERYBODY AGREES WITH [HN1] THE BASIC ELEMENTS THAT THE PLAINTIFF HAS TO PROVE TO SHOW SUCH CAUSE OF ACTION, THAT IS, MISREPRESENTATION OF MATERIAL FACT AND I WILL ASSUME THAT CAN INCLUDE AN OMISSION. NUMBER TWO, WITH INTENT TO INDUCE RELIANCE, THREE, IGNORANCE OF THE TRUTH ON THE PART OF THE PERSON RECEIVING THE INFORMATION, JUSTIFIABLE RELIANCE AND RESULTING DAMAGES.

THE DOCUMENTS THERE WHICH YOU HAVE SUBMITTED IN SUPPORT OF AND OPPOSITION TO THESE MOTIONS, OF COURSE, DISCUSS ALL THESE FACTUAL ISSUES AND GO BACK AND FORTH ON WHO SAID WHAT. HOWEVER, I THINK THERE IS ONE ELEMENT HERE THAT IS ABSOLUTELY FATAL TO THE RTC'S CLAIM AGAINST UMIC, AND THAT IS THE ISSUE OF JUSTIFIABLE RELIANCE.

EVEN WORKING FROM RTC'S PAPERS, THE GUTS OF UNDISPUTED FACTS HERE, WHICH II JUST THINK ARE ABSOLUTELY OVERWHELMING TO SHOW THAT IT WAS MR. ONG AND PERHAPS MR. AZEVEDO WHO WERE DRIVING THESE INVESTMENTS AND NOT THE BROKERS.

MR. ONG WAS THE CEO OF CABRILLO. IT'S A THREE-BANK SAVINGS -- BRANCH SAVINGS AND LOAN ASSOCIATION, AND HAD DEPOSITS OF OVER SIXTY-TWO MILLION DOLLARS AT THE TIME IT BECAME ACTIVE IN TRADING OF STRIPS. SO WE CAN HARDLY CONTEND THAT THE BANK WAS A WIDOW OR [*5] AN ORPHAN.

IN ADDITION MR. ONG HIMSELF HAD A DEGREE IN ACCOUNTING. HE WAS A FORMER CHIEF FINANCIAL OFFICER, WAS A CHIEF EXECUTIVE OFFICER, WAS AN INVESTMENT OFFICER, AND PRESIDENT FOR TWO YEARS BEFORE HE STARTED TRADING STRIPS, AND HE FOLLOWED PRICES AND THE POSITIONS IN THE STRIPS ON A DAILY BASIS.

CABRILLO BECAME A CLIENT OF UMIC AS A RESULT OF A SALESMAN'S COLD CALL. AND UMIC NOTIFIED ONG OF THE PRICES, THE EXECUTED TRANSACTIONS ADVISED HIM OF THE RESULTING PROFITS AND LOSSES. ONG'S NORMAL PRACTICE WAS TO REVIEW THE ACCOUNT STATEMENTS HE RECEIVED AND TO MONITOR ON A DAILY BASIS THE PERFORMANCE OF THESE SECURITIES.

THE FIRST INVESTMENT HE MADE IN STRIPS WAS VERY, VERY PROFITABLE, IN A VERY SHORT PERIOD OF TIME. SO OBVIOUSLY IT ALERTED ANYBODY WHO HAS TAKEN ACCOUNTING 1-A OR FINANCE 1-A THAT THESE INSTRUMENTS ARE VOLATILE.

AND WE HAVE THE FACT THAT IN '87 OR VERY EARLY '87 CABRILLO HIRED ITS OWN CONSULTANT TO ADVISE IT ABOUT INVESTING IN STRIPS AND THE CONSULTANTS SAID DON'T BUY ANY MORE. TALK ABOUT KNOWLEDGE. OKAY.

WITH RESPECT TO TRANSACTIONS THAT ACTUALLY OCCURRED, IT WAS VERY OBVIOUS THAT THE SECURITIES VALUE CHANGES, THE MARKET RATE CHANGES INVERSELY, OF COURSE, SINCE THEY'RE [*6] ESSENTIALLY

INVOLVED. HE MADE AN AWFUL LOT OF MONEY WHEN THE INTEREST RATES DECLINED AND CERTAINLY ANYONE KNOWS THAT YOU LOSE AN EQUAL OR A MULTIPLE OF THAT IF THE INTEREST RATES RISE ANY.

WITH ALL OF THOSE FACTS, IT'S JUST INCONCEIVABLE THAT A FINANCIAL CHIEF EXECUTIVE OFFICER IS GOING TO RELY UPON THE STATEMENTS OF A COLD CALL BOND SALESMAN TO MAKE HIS INVESTMENT DECISIONS.

WITH ALL THAT INFORMATION, WITH ALL THAT SOPHISTICATION, WITH ALL THAT INVESTMENT, AND I SUBMIT GREED DRIVEN DESIRE FOR INVESTMENT AND GROWTH IN THIS INSTITUTION, WE'RE SUPPOSED TO BELIEVE THAT MR. ONG RELIED ON A COLD CALL SALESMAN WITH GENERAL REPRESENTATIONS OF WHAT WERE THE WORDS SUBSTANTIAL DROP, NO RISK, NOT VOLATILE. IT JUST REALLY BORDERS ON NONSENSE.

AND, INDEED, I DON'T THINK THE RTC EVEN ANSWERS THIS QUESTION ON JUSTIFIED RELIANCE. THE ONLY THING I FIND IN THE ASSERTIONS HERE IS JUST A BALD ASSERTION THAT MR. ONG QUOTE "JUSTIFIABLY RELIED" CLOSE QUOTE ON THE ADMISSION -- ON THE OMISSIONS.

IT WAS MR. ONG'S JOB TO MANAGE THE BANK'S ASSETS, AND HE DID SO. IT WASN'T THE BROKERS. MR. ONG IS THE ONE WHO KNEW THE BANK'S FINANCIAL CONDITION, WHAT ITS ASSET PORTFOLIO LOOKED LIKE, WHAT ITS LIABILITIES WERE, [*7] WHETHER THE ASSETS HAD TO MATURE IN ORDER TO COVER THE MATURITIES OF THE OBLIGATIONS THE BANK HAD. THAT IS HIS JOB. THAT'S THE BANK'S JOB. THAT'S NOT THE BROKERS' JOB.

THEY COME TO THE BANK WITH AN INVESTMENT OPPORTUNITY AND PRESENT IT. THEY'RE DEALING WITH VERY SOPHISTICATED PEOPLE, SEVERAL DEGREES OF REVIEW, AND II JUST DON'T THINK THERE IS ANY BASIS AT ALL FOR CLAIMING THAT THERE WAS, IN FACT, RELIANCE AT ALL.

I THINK THIS IS JUST AN ATTEMPT TO THROW A LOSS OFF TO SOMEBODY BECAUSE THAT SOMEBODY IS AROUND AND SOMEBODY HAS MONEY.

CERTAINLY EVEN IF THERE WERE A CLAIM OF RELIANCE BY MR. ONG, THERE IS CERTAINLY NO GENUINE ISSUE OF MATERIAL FACT, NO JUSTIFIED FACTS.

I AM VERY CONCERNED ABOUT WHAT I SEE IN MR. ONG'S TESTIMONY, ALBEIT I HAVE NOT READ EVERYTHING HE SAID IN ALL OF ITS INCLINATIONS. I READ ENOUGH TO BE VERY CONCERNED ABOUT THE CHANGES IN HIS TESTIMONY AND ABOUT THE TESTIMONY HE HAS GIVEN. JUST ONE POINT OF VIEW OF WHETHER HE IS MISREPRESENTING THINGS TO A COURT.

HOWEVER, IN MAKING THE DECISIONS I AM MAKING HERE, I AM NOT WEIGHING MR. ONG'S CREDIBILITY, I'M TAKING AT FACE VALUE THE THINGS HE SAID IN FAVOR OF RTC'S POSITION.

SO UMIC'S MOTION FOR SUMMARY JUDGMENT ON THE NEGLIGENT [*8] MISREPRESENTATION CLAIM IS GRANTED.

ON THE FIDUCIARY DUTY CLAIM, WE MAY HAVE AT LEAST SUPERFICIALLY AN ISSUE OF WHETHER THE FEDERAL LAW ON THIS QUESTION APPLIES OR WHETHER STATE LAW APPLIES. HOWEVER, I DON'T THINK IT REALLY MAKES ANY DIFFERENCE IN THIS CASE.

IN FEDERAL COURT WE HAVE A FEDERAL SYSTEM, WE HAVE WHAT I BELIEVE IS WELL-DEFINED AUTHORITY OF CARAVAN MOBILE HOME SALES AGAINST LEHAM BROTHERS, AND IN THE STATE, STATE LAW SYSTEM WE HAVE THE DUFFY VERSUS CAVALIER DECISION OF THE CALIFORNIA COURT.

ALTHOUGH THEY MAY APPROACH THINGS FROM OPPOSITE ENDS OF THE TELESCOPE, I THINK THEY ARRIVE AT THE SAME POINT, AND THAT IS, IF WE HAVE AN ACCOUNT THAT IS NOT DISCRETIONARY, A SOPHISTICATED CLIENT, THE CLIENT INITIATES THE TRADES, THE BROKER EXECUTES THE TRADES, AND OF COURSE, PROBABLY PUSHES THE CLIENT TO MAKE SOME BUYS OR SALES, THAT IS THE NATURE OF THE INDUSTRY, THAT WE DO NOT HAVE A FIDUCIARY DUTY.

THIS ACCOUNT WAS NOT A DISCRETIONARY ACCOUNT. MR. ONG WAS NOT A MAJOR INVESTOR, QUITE THE OPPOSITE. HE WAS A HEAVY RISK TAKER. AND IT WAS CABRILLO WHO WAS CALLING THE SHOTS OF WHETHER HE WAS BUYING OR WHETHER UMIC DID ITS EXECUTION.

I THINK THE RECORD IS BEYOND DISPUTE THAT MR. ONG [*9] AND MR. AZEVEDO WERE

THE ONES WHO HAD THE AUTHORITY TO TRADE THE STRIPS AND THE BROKERS HAD NO AUTHORITY TO DO IT.

SO I AM FINDING THE ABSENCE OF A FIDUCIARY DUTY, AND THE MOTION FOR SUMMARY JUDGMENT FOR BREACH OF FIDUCIARY DUTY, WHICH IS THE SEVENTH CAUSE OF ACTION, IS GRANTED IN FAVOR OF UMIC.

I BELIEVE THAT THOSE ARE THE ONLY CAUSES OF ACTION AGAINST UMIC, SO SUMMARY JUDGMENT MOTION FOR UMIC IS GRANTED.

TURNING TO PRUDENTIAL. I THINK THE SAME ANALYSIS AND THE SAME RESULT. AND THAT IS, THERE ARE SOME, OF COURSE, FACTUAL DIFFERENCES. THE PRU SALESMAN APPARENTLY HAD THE . . . I DON'T KNOW WHAT I WANT TO SAY, HAD THE NERVE TO TRY TO PREDICT INTEREST RATES. I SAY "NERVE", I GUESS EVERYBODY WHO INVESTS IN FIXED INCOME SECURITIES TRIES TO PREDICT, SUCH AS HOMEOWNERS IN FINANCING OUR OWN HOUSES WE TRY TO PREDICT IT, BUT THIS APPARENTLY, HIS THOUGHTS WERE CONVEYED TO MR. ONG, BUT I DON'T THINK THAT MAKES A DARN BIT OF DIFFERENCE.

AND SIMPLY CALLING STRIPS A GOOD INVESTMENT, AND TO THAT -- TO SUBJECT SOMEBODY TO A MULTIMILLION DOLLAR LIABILITY BECAUSE THEY TELL A SOPHISTICATED INVESTOR THAT SOMETHING IS A GOOD INVESTMENT IS REALLY NOT SUPPORTABLE.

I DON'T THINK THE ADDING OF THE NATIONAL [*10] FEDERAL SECURITIES TRUST INVESTMENT INTO THE FACTS MAKE ANY DIFFERENCE. I THINK IT ALL COMES OUT THE SAME WAY. AND I DON'T THINK IT'S PARTICULAR WITH RESPECT TO THOSE, THAT THERE IS REALLY ANY GREAT MISREPRESENTATIONS OR ANY MISREPRESENTATIONS AT ALL.

BUT I THINK, AS I HAVE SAID, THE CLAIM AGAINST PRU, I THINK, FAILS FOR THE SAME REASON THAT THE CLAIM AGAINST UMIC FAILS, AND THAT IS, THERE IS NO GENUINE ISSUE OF MATERIAL FACT, THERE IS NO JUSTIFIABLENESS OF ANYTHING PRU DID.

THE SAME WITH RESPECT TO FIDUCIARY DUTY CLAIM, 11 JUST DON'T THINK IT'S THERE FOR THE REASONS I STATED WITH RESPECT TO UMIC.

SO, THE FOURTH CAUSE OF ACTION AND THE FIFTH CAUSE OF ACTION WILL BE -- SUMMARY JUDGMENT WILL BE GRANTED IN FAVOR OF PRU. AND I BELIEVE THOSE ARE THE ONLY TWO CAUSES OF ACTION AGAINST PRU. SO PRU IS OUT.

TURNING TO THE DEFENDANT PEAT MARWICK'S MOTION. WE DEAL WITH SLIGHTLY DIFFERENT ISSUES, BUT ONE VERY SIMILAR UNDERLYING CLAIM, AND THAT IS, "I'M NOT RESPONSIBLE.' THAT IS, "I, THE BANK, AM NOT RESPONSIBLE." "I DID WRONG, BUT YOU DIDN'T STOP ME FROM DOING WRONG." AND I JUST DON'T THINK THAT WASHES.

THE CLAIMS HERE ARE THAT PEAT MARWICK ERRONEOUSLY QUOTE "ALLOWED" END OF QUOTE CABRILLO TO KEEP [*11] ITS INVESTMENTS ON ITS BALANCE SHEET ON A HISTORICAL COST RATHER THAN MARKET TO MARKET. THAT IN 1988 FOR THE FIRST TIME PEAT MARWICK INFORMED CABRILLO THAT BECAUSE SOME OF ITS INVESTMENTS WERE NEGATIVE, THAT IS, THEY HAD LOSSES, ALL OF THE INVESTMENTS WOULD HAVE TO BE CARRIED . . . BE MARKED DOWN TO MARKET VALUE AND SOLD SOME OF THEM, AND THE CLAIM IS THAT IF PEAT MARWICK HAD TOLD CABRILLO THAT CABRILLO WAS DOING BAD THINGS, IT WOULD HAVE DONE SOMETHING EARLIER ABOUT IT AND WOULD HAVE AVOIDED THE LOSS.

THE CLAIMS AGAINST PEAT MARWICK ARE BASED UPON BREACH OF CONTRACT AND BREACH OF FIDUCIARY DUTY. AND, HOWEVER, I BELIEVE THAT THE BREACH OF FIDUCIARY DUTY CLAIM HAS ALREADY BEEN DISMISSED, SO WE ARE DEALING WITH BREACH OF CONTRACT.

AND AS I HAVE SAID BEFORE, IT GETS INTO THE CLAIM OF YOU HAD A DUTY TO STOP ME FROM DOING BAD. NOW, THERE IS A BIG DISPUTE HERE IN THE PAPERS BETWEEN THE PLAINTIFFS AND THE PEAT MARWICK OVER WHAT INFORMATION I SHOULD OR SHOULD NOT CONSIDER, AND WHO IS CREDIBLE AND WHO IS NOT.

AGAIN, AS I STATED, I HAD SERIOUS QUESTION WITH MR. ONG'S CREDIBILITY. HOWEVER, I HAVE TO TAKE THE STATEMENTS THAT THE OFFICERS AND DIRECTORS AT FACE

VALUE, AND I'M NOT MAKING ANY RULING [*12] ON CREDIBILITY OR STRIKING SOMEBODY'S DECLARATIONS OR ANYTHING LIKE THAT.

BUT EVEN ACCEPTING RTC'S ASSERTION AS ALL BEING TRUE, THERE IS REALLY ONE GROUND ON WHICH SUMMARY JUDGMENT MUST BE GRANTED, AND THAT IS, THE TOTAL ABSENCE OF CAUSATION.

THIS COMPANY DECIDED FOR ITSELF TO BUY AND SELL STRIPS AND TO TRADE IN THEM. IT MADE THOSE DECISIONS IN THE FACE OF CONSULTANT'S CONTRARY ADVICE AND THE ABSENCE OF THE FACE OF COMMON SENSE TO BE TRADING INSTRUMENTS LIKE THIS.

AND I DON'T THINK IT CREATES ANY PROXIMATE CAUSATION WHATSOEVER TO SAY, WELL, OUR AUDITOR DIDN'T STOP US FROM PUTTING THESE INVESTMENTS ON OUR BOOKS AT COST RATHER THAN MARKET. AGAIN, THE "I DID WRONG, BUT YOU SHOULD HAVE STOPPED ME" AND "IF YOU DIDN'T STOP ME, YOU'RE LIABLE FOR EVERYTHING I DID WRONG". THAT JUST DOESN'T GO.

AGAIN, THIS BANK IS A FINANCIAL INSTITUTION. MR. ONG WAS A SOPHISTICATED PERSON. MR. AZEVEDO WAS . . . THEY HAD AN ACCOUNTING DEPARTMENT. THIS IS A REGULATED INDUSTRY. IT'S NOT ONE WHERE THEY CAN CREATE THEIR OWN SETS OF BOOKS, IT'S A REGULATIVE INDUSTRY GOVERNED BY THE FEDERAL HOME LOAN BANK BOARD, AUDITED, AUDIT REPORTS GOING IN VARIOUS DIRECTIONS, AND ONE FUNDAMENTAL THING IS MISSING FROM THE STATEMENTS [*13] THAT HAVE BEEN MADE. REGARDLESS OF THE FACT THAT A COMPANY IS AUDITED, ITS FINANCIAL STATEMENTS ARE ITS OWN RESPONSIBILITY.

THE AUDIT STANDARD OF GAP AND GAS DON'T ELIMINATE THE REQUIREMENT THAT THE COMPANY ITSELF IS THE ONE WHO HAS THE PRIMARY RESPONSIBILITY FOR THE ACCURACY OF ITS ACCOUNT.

PEAT MARWICK DID SHOW FIGURES AT BOTH COST AND MARKET. THE BANK IGNORED THE CONSULTANT'S ADVICE. IT WAS A CONSCIOUS DECISION MADE BY THE BOARD TO KEEP ON WITH THIS TYPE OF INVESTMENTS AND NOT LIQUIDATE THEM EVEN AFTER THERE WERE DECLINES IN VALUE. THOSE WERE INVESTMENT DECISIONS, NOT ACCOUNTING DECISIONS.

THE ACCOUNTANT WAS NOT A GENERAL ADVISOR TO THE BOARD OF DIRECTORS, AND IT WAS ITS OWN INVESTMENT DECISION. SO THE INVESTMENT DECISIONS HERE WERE DRIVEN BY THE INVESTMENTS THEMSELVES AND NOT DRIVEN BY THE ACCOUNTING FOR THOSE INVESTMENT DECISIONS.

SO I THINK THERE IS A TOTAL ABSENCE OF ANY SHOWING OF PROXIMATE CAUSE, SO SUMMARY JUDGMENT WILL BE GRANTED IN FAVOR OF PEAT MARWICK ON THE BREACH OF CONTRACT CLAIM, WHICH I BELIEVE THE EIGHTH CLAIM, AND I BELIEVE FIDUCIARY DUTY HAS ALREADY BEEN DISMISSED, SO SUMMARY JUDGMENT FOR PEAT MARWICK.

NOW, I'M STATING WHAT I'M SAYING IN RATHER HARSH TERMS, I [*14] GUESS, AND IN A SENSE, THEY'RE MISDIRECTED. THIS SHOULD REALLY BE AIMED AT THE BANK, BUT, OF COURSE, THE BANK ISN'T AROUND.

I APPRECIATE RTC'S POSITION HERE. THEY'RE COMING IN AFTER THE FACT. THEY'VE GOT TO PICK UP THE ASSETS AND LIABILITIES OF A FAILED INSTITUTION, THEY HAVE TO DEAL WITH THE PEOPLE WITHIN THE BANK WHO HAD SOME ROLE, NOT NECESSARILY ALL, BUT SOME ROLE IN THE BANK FAILURE, AND THEY HAVE TO TRY TO SALVAGE WHAT THEY CAN AND TRY TO GET WHAT THEY CAN.

BUT, THIS ATTEMPT TO THROW THIS TYPE OF A LOSS ON THIRD PARTY PROFESSIONALS, I JUST THINK JUST CANNOT PASS A SUMMARY JUDGMENT STANDARD. EVEN A FIRST-YEAR ACCOUNTING STUDENT KNOWS THE DIFFERENCE BETWEEN THE LOWER COST IN MARKET AND KNOWS THE CONCEPT, AND ANY INVESTMENT PERSON SUCH AS MR. ONG KNOWS THAT THINGS GO ROARING UP, THEY CAN GO ROARING DOWN AGAIN.

THIS WAS THE BANK'S RISK, THE BANK'S DECISION, AND IT OUGHT TO LIE WITHIN THE BANK AND AMONG ITS OFFICERS AND DIRECTORS.

SO I WILL ASK PEAT MARWICK, UMIC AND PRUDENTIAL TO SUBMIT PROPOSED FORMS OF ORDER GRANTING SUMMARY JUDGMENT. THE ORDER SHOULD SIMPLY STATE THAT I HAVE PUT THE REASONS FOR MY DECISION ON THE RECORD IN OPEN COURT. YOU NEED NOT RECITE ALL THOSE REASONS, JUST [*15] REFER TO THE FACT THAT THEY'RE ON THE RECORD IN OPEN COURT.

WE STILL HAVE TO PROCEED ON THE TRACK OF THE DIRECTORS, BUT I THINK RATHER THAN DOING THAT TODAY, BECAUSE I'M MAKING SUCH A SUBSTANTIAL CHANGE IN THIS CASE, THAT WE BETTER POSTPONE THAT FOR A COUPLE OF WEEKS ANYWAY.

I BELIEVE YOU HAVE AN ENE DATE COMING UP IN OCTOBER. I THINK WE BETTER START DEFINING THINGS IN THIS CASE BEFORE THEN. LET ME SUGGEST A STATUS CONFERENCE ON OCTOBER THE 8TH.

IF YOU ALL AGREE THAT THE BETTER THING TO DO IS PUT IT OVER UNTIL AFTER THE ENE DATE, I'M WILLING TO DO THAT.

MR. PARISH: I THINK MOST OF THE DIRECTORS, I SEE MR. TAYLOR, I THINK THEY'RE HERE.

MY INCLINATION WOULD BE TO WAIT UNTIL AFTER THE ENE.

THE COURT: WHAT DO THE DIRECTOR DEFENDANTS THINK?

MR. MEZZETTI: ROBERT L. MEZZETTI, II.

I AGREE WITH THAT.

THE COURT: ALL RIGHT. I WILL GO ALONG WITH IT.

LET'S PUT IT OFF THEN. THE ENE SESSION IS THE 22ND?

MR. PARISH: 22ND, YOUR HONOR.

THE COURT: LET'S SET THIS FOR THE 29TH, OCTOBER 29TH FOR STATUS.

ALL RIGHT. THE MATTER IS ADJOURNED.

(PROCEEDINGS ADJOURNED)

CERTIFICATE OF REPORTER

I, DIANE E. SKILLMAN, THE UNDERSIGNED OFFICIAL COURT REPORTER FOR THE UNITED STATES DISTRICT COURT FOR THE NORTHERN [*16] DISTRICT OF CALIFORNIA, 450 GOLDEN GATE AVENUE, SAN FRANCISCO, CALIFORNIA, DO HEREBY CERTIFY:

THAT THE FOREGOING TRANSCRIPT, PAGES NUMBERED 1 THROUGH 14, INCLUSIVE, CONSTITUTES A FULL, TRUE AND CORRECT TRANSCRIPT OF MY SHORTHAND NOTES TAKEN AS SUCH OFFICIAL REPORTER TO THE PROCEEDINGS HEREINBEFORE ENTITLED, AND REDUCED TO TYPEWRITING TO THE BEST OF MY ABILITY.

DIANE E. SKILLMAN

OFFICIAL COURT REPORTER, C.S.R. 4909

Tab 3

LEXSEE 2004 U.S. DIST. LEXIS 22757

THEODORE C. SWARTZ, Plaintiff(s), v. KPMG, LLC; PRESIDIO GROWTH, LLC; PRESIDIO ADVISORY SERVICES, INC., HAYES STREET MANAGEMENT, INC.; NORWOOD HOLDINGS, INC.' DEUTSCHE BANK AG; DEUTSCHE BANK SECURITIES, INC.' SIDLEY AUSTIN BROWN & WOOD, LLP; DALE R. BAUMANN; JOHN M. LARSON; ROBERT A. PFAFF, DAVID AMIR MAKOV; STEVEN BUSS; AND R.J. RUBLE, and their respective marital communities, if any, Defendant(s).

NO. C03-1252P

UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON

2004 U.S. Dist. LEXIS 22757

February 13, 2004, Decided

DISPOSITION: Defendants' motions to dismiss granted in part and denied in part.

CASE SUMMARY:

PROCEDURAL POSTURE: Plaintiff, an investor, sued defendants, inter alia, an accounting firm, a bank, several companies, fund managers, and a law firm, alleging violations of the Racketeer Influenced & Corrupt Organizations Act (RICO), the Washington Consumer Protection Act (WCPA), fraud, negligent misrepresentation, breach of contract and fiduciary duty, professional negligence, and conspiracy. The firm, bank, companies, managers, and law firm moved to dismiss.

OVERVIEW: The investor's claims centered around an allegedly fraudulent tax shelter scheme. The court held that the investor's RICO claims were barred under *18 U.S.C.S. § 1964*(c) because it was evident from the pleadings that the alleged fraud was in connection with the sale of securities. The court further held that the investor could not establish the reasonable reliance requirement for his fraud claims because he was advised of the possibility of an audit and potential disallowance of the tax shelter. The court then held that the investor failed to establish his WCPA claim because the tax shelter scheme did not have the capacity to deceive or affect a substantial portion of the public, that the investor failed to adequately state his contract claims against the accounting and law firm, and that the investor's Declaratory Judgment Act claim was not ripe. The court finally held that the investor adequately pleaded his breach of fiduciary duty claim against the law firm as well as his professional malpractice claims, that there was no showing of reliance in support of the negligent misrepresentation claim, and that the civil conspiracy claims survived against the accounting and law firms.

OUTCOME: The motions to dismiss were denied regarding the investor's breach of fiduciary duty claim against the law firm, as well as his professional malpractice and civil conspiracy claims against the accounting and law firms. The motions to dismiss were granted regarding the investor's remaining claims.

LexisNexis(R) Headnotes

Civil Procedure > Pleading & Practice > Defenses, Objections & Demurrers > Motions to Dismiss

[HN1] The court reviews motions to dismiss pursuant to the requirements of *Fed. R. Civ. P. 12(b)*. All allegations of material fact are taken as true and construed in the light most favorable to the nonmoving party.

Civil Procedure > Pleading & Practice > Defenses, Objections & Demurrers > Motions to Dismiss

[HN2] Conclusory allegations and unwarranted inferences are insufficient to defeat a motion to dismiss. A complaint should not be dismissed unless it appears beyond doubt that the plaintiff can prove no set of facts in support of the claim that would entitle the plaintiff to relief.

Securities Law > Bases for Liability > Private Securities Litigation

Securities Law > Bases for Liability > Racketeer Influenced & Corrupt Organizations
[HN3] See *18 U.S.C.S. § 1964*(c).

Securities Law > Bases for Liability > Private Securities Litigation
Securities Law > Bases for Liability > Racketeer Influenced & Corrupt Organizations
[HN4] The rule that a plaintiff cannot assert a Racketeer Influenced & Corrupt Organizations Act (RICO) claim based on predicate acts that sound in securities fraud is applicable even if the claim is plead as a matter of mail fraud or wire fraud. The exclusion applies even if the RICO plaintiff could not have asserted the securities fraud claim himself.

Securities Law > Initial Public Offerings & the Securities Act of 1933 > Definitions
[HN5] The definition of securities found in *15 U.S.C.S. § 77b*(a)(1) includes any stock and any option relating to foreign currency.

Securities Law > Bases for Liability > Deceptive Devices
Securities Law > Bases for Liability > Private Securities Litigation
Securities Law > Bases for Liability > Racketeer Influenced & Corrupt Organizations
[HN6] The United States Supreme Court (Supreme Court) has made it clear that the "in connection with" requirement of *17 C.F.R. § 240.10b-5* is satisfied if the scheme to defraud and the sale of securities coincide and neither the Securities and Exchange Commission nor the Supreme Court has ever required a misrepresentation about a stock's value in order to activate the statutory prohibitions for asserting a Racketeer Influenced & Corrupt Organizations Act claim based on predicate acts that sound in securities fraud; the United States Court of Appeals for the Ninth Circuit is in accord.

Securities Law > Bases for Liability > Private Securities Litigation
Securities Law > Bases for Liability > Racketeer Influenced & Corrupt Organizations
[HN7] The fact that a defendant's alleged misrepresentations were unrelated to the value of the securities does not foreclose application of the bar under *18 U.S.C.S. § 1964*(c) for asserting a Racketeer Influenced & Corrupt Organizations Act claim based on predicate acts that sound in securities fraud, nor does the fact that the defendants themselves were not issuers of the securities.

Securities Law > Bases for Liability > Deceptive Devices

Securities Law > Bases for Liability > Private Securities Litigation
Securities Law > Bases for Liability > Racketeer Influenced & Corrupt Organizations
[HN8] The United States Court of Appeals for the Ninth Circuit has applied *17 C.F.R. § 240.10b-5* to securities transactions marketed as tax shelters and has held that the Private Securities Litigation Reform Act, Pub. L. No. 104-67, 109 Stat. 737, barred a Racketeer Influenced & Corrupt Organizations Act suit where plaintiffs were neither buyers or sellers of the stock. The United States Court of Appeals for the Eleventh and Eighth Circuits are in accord: misconduct which induces plaintiffs to engage in a stock transaction (regardless of whether they would have standing to sue for securities fraud) satisfies the "in connection with" requirement under *17 C.F.R. § 240.10b-5*.

Torts > Business & Employment Torts > Deceit & Fraud
[HN9] An essential element of fraud is proof of reasonable reliance on allegedly fraudulent statements. Oral representations cannot establish reasonable reliance as a matter of law where there are written documents which contradict any oral statements.

Antitrust & Trade Law > Private Actions > Racketeer Influenced & Corrupt Organizations
Securities Law > Bases for Liability > Racketeer Influenced & Corrupt Organizations
[HN10] The United States Court of Appeals for the Ninth Circuit has held that a plaintiff who enters into a transaction knowing that there are a range of possible outcomes cannot state a Racketeer Influenced & Corrupt Organizations Act claim simply because he received a less favorable outcome within the stated range.

Torts > Business & Employment Torts > Deceit & Fraud
[HN11] A promise that is not a representation of an existing fact cannot form the basis for a fraud claim.

Antitrust & Trade Law > Consumer Protection > Deceptive Acts & Practices
[HN12] A successful Washington Consumer Protection Act claim requires the establishment of the following elements: (1) an unfair or deceptive act or practice; (2) occurring in trade or commerce; (3) affecting the public interest; (4) that injures the plaintiff in his or her business or property; and (5) a causal link between the unfair or deceptive act and the injury suffered.

Antitrust & Trade Law > Consumer Protection > Deceptive Acts & Practices

[HN13] An act or practice is unfair or deceptive under the Washington Consumer Protection Act (WCPA) only if it has the capacity to deceive a substantial portion of the public. As a matter of law, conduct directed toward a small group cannot support a WCPA claim.

Antitrust & Trade Law > Consumer Protection > Deceptive Acts & Practices

[HN14] The tribulations of multimillionaires are not the focus of the legislative intent behind the Washington Consumer Protection Act (WCPA); as a (very small) group, the extremely wealthy are neither unsophisticated nor easily subject to chicanery. A WCPA claim has been dismissed on public interest grounds based on a finding that the plaintiff was not representative of bargainers vulnerable to exploitation.

Legal Ethics > Client Relations > Effective Representation

Contracts Law > Breach > Causes of Action

Torts > Malpractice Liability > Attorneys

[HN15] Washington law holds that legal malpractice is not a liability express or implied arising out of a written agreement unless the agreement guarantees a specific result or assures the effect of legal services. Where a complaint does not allege that the contract guaranteed a result, any promises to provide professionally competent advice and services or to exercise the applicable standard of care are, therefore, nothing more than implied duties of counsel to client that do not arise from a contract.

Business & Corporate Entities > Agency > Causes of Action & Remedies > Breach of Contract

Business & Corporate Entities > Agency > Disclosure

Contracts Law > Breach > Nonperformance

[HN16] An agent, by making a contract only on behalf of a competent disclosed or partially disclosed principal, does not thereby become liable for its nonperformance. An agent is not liable for the contractual duties of its principal.

Civil Procedure > Remedies > Declaratory Relief

[HN17] In order to maintain a claim under the Declaratory Judgment Act, a plaintiff must establish standing by showing that there is a substantial controversy, between parties have adverse interest, of sufficient immediacy and reality to warrant issuance of a declaratory judgment. A declaratory judgment is not ripe for adjudication if it rests upon contingent future events that may not occur as anticipated, or indeed may not occur at all.

Civil Procedure > Pleading & Practice > Pleadings > Amended Pleadings

[HN18] Where a plaintiff cannot allege any set of facts consistent with the facts already before the court which could possibly cure the defects of his pleading, leave to amend will not be granted.

Contracts Law > Contract Interpretation > Fiduciary Responsibilities

[HN19] The existence of a fiduciary relationship is not simply a matter of reposing trust and confidence in the integrity of another. There must be additional circumstances, or a relationship that induce the trusting party to relax the care and vigilance which he would ordinarily exercise for his own protection. When the parties are dealing with each other at arm's length, the special circumstances which give rise to a fiduciary relationship do not exist.

Contracts Law > Contract Interpretation > Fiduciary Responsibilities

Torts > Malpractice Liability > Attorneys

[HN20] It is a common practice for plaintiffs to plead both legal malpractice and breach of fiduciary duty against attorney-defendants.

Torts > Business & Employment Torts > Deceit & Fraud

Torts > Business & Employment Torts > Negligent Misrepresentation

[HN21] Negligent misrepresentation, like fraud, requires a showing of reliance.

Torts > Multiple Defendants > Conspiracy

[HN22] A civil conspiracy is a combination of two or more persons to commit a criminal or unlawful act, or to commit a lawful act by criminal or unlawful means. A properly plead conspiracy must set forth with particularity the facts and circumstances constituting the alleged conspiracy. Conclusory statements will not suffice to state a conspiracy claim. A claim for civil conspiracy is entirely dependent on underlying substantive claims; where the underlying claims fail, the civil conspiracy claim must also fail.

Civil Procedure > Jurisdiction > Personal Jurisdiction & In Rem Actions > Personal Jurisdiction

[HN23] It is a plaintiff's burden to establish that personal jurisdiction over the named defendants exists.

Civil Procedure > Jurisdiction > Personal Jurisdiction & In Rem Actions > Personal Jurisdiction

[HN24] For personal jurisdiction purposes, it is not acceptable for a plaintiff to hale a party into court, then ask leave to conduct discovery to establish that he had a right to do so.

COUNSEL: [*1] For Theodore C Swartz, Plaintiff: Duncan Calvert Turner, Don Paul Badgley, Randall C

Johnson, Jr, BADGLEY MULLINS LAW GROUP, SEATTLE, WA; Jonathan P Meier, Richard E Spoonemore, SIRIANNI YOUTZ MEIER & SPOONEMORE, SEATTLE, WA.

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For Presidio Growth LLC, Presidio Advisory Services Inc, Defendants: Elizabeth Lamzaki, Ellen K Brown, Steven M Bauer, LATHAM & WATKINS, SAN FRANCISCO, CA; Stephen C Willey, SAVITT & BRUCE LLP, SEATTLE, WA.

For Hayes Street Management Inc, Defendant: Ellen K Brown, Steven M Bauer, LATHAM & WATKINS, SAN FRANCISCO, CA; Stephen C Willey, SAVITT & BRUCE LLP, SEATTLE, WA.

For Deutsche Bank AG, Deutsche Bank Securities Inc, Defendants: Benjamin Sokoly, Kelly Librera, Lawrence M Hill, Richard A Nessler, Seth C Farber, DEWEY BALLANTINE, NEW YORK, NY; Linda C Severin, GARVEY SCHUBERT BARER, SEATTLE, WA.

For Sidley Austin Brown & Wood LLP, Defendant: Brad D Brian, Jonathan E Altman, Lisa J. Demsky, Richard [*2] E Drooyan, Susan R Szabo, MUNGER TOLLES & OLSON, LOS ANGELES, CA; Rudy Albert Englund, LANE POWELL SPEARS LUBERSKY, SEATTLE, WA.

For Dale R Baumann, Defendant: Charles J Ha, George E Greer, HELLER EHRMAN WHITE & MCAULIFFE, SEATTLE, WA; Chaya F Weinberg-Brodt, Rachel B Kane, Stephen L Ascher, William J Schwartz, William H O'Brien, KRONISH LIEB WEINER & HELLMAN LLP, NEW YORK, NY; Angelo J Calfo, YARMUTH WILSDON CALFO, SEATTLE, WA.

For R J Ruble and their respective marital communities, if any, Defendant: Jessica L Goldman, SUMMIT LAW GROUP, SEATTLE, WA; Stuart E. Abrams, Frankel & Adams, New York, NY.

JUDGES: Marsha J. Pechman, United States District Judge.

OPINIONBY: Marsha J. Pechman

OPINION:

ORDER ON MOTIONS TO DISMISS

RE: CLAIMS FOR RICO, FRAUD, CONSPIRACY, BREACH OF CONTRACT, WASHINGTON CONSUMER PROTECTION ACT, NEGLIGENT MISREPRESENTATION, BREACH OF FIDUCIARY DUTY AND PROFESSIONAL MALPRACTICE

The Court, having received and reviewed:

1. Motion of Sidley Austin Brown & Wood LLP and R.J. Ruble to Dismiss

2. Plaintiff's Opposition to Motion of Defendants Sidley Austin Brown & Wood LLP and R.J. Ruble to Dismiss

3. Reply of Defendants Sidley Austin Brown & Wood LLP and R. [*3] J. Ruble to Dismiss

4. Defendants KPMG LLP's and Dale R. Baumann's Motion to Dismiss Plaintiff's Complaint

5. Plaintiff's Opposition to KPMG and Baumann's Motion to Dismiss Complaint

6. Defendants KPMG LLP's and Dale R. Baumann's Reply Brief in Support of Motion to Dismiss Plaintiff's Complaint

7. Defendants Presidio Growth, LLC's and Presidio Advisory Services, Inc.'s Notice of Motion and Motion to Dismiss

8. Plaintiff's Legal Memorandum in Opposition to Motion to Dismiss of Presidio Defendants

9. Defendants Presidio Growth, LLC's and Presidio Advisory Services, Inc.'s Reply Memorandum in Support of Defendants' Motion to Dismiss

10. Notice of Subsequent Authority Submitted by Defendants Presidio Growth, LLC's and Presidio Advisory Services, Inc.'s in Support of Motion to Dismiss

11. Defendants Deutsche Bank AG and Deutsche Bank Securities, Inc.'s Notice of Motion and Motion to Dismiss and Memorandum of Law in Support Thereof

12. Plaintiff's Opposition to Deutsche Bank's Motion to Dismiss

13. Defendants Deutsche Bank AG and Deutsche Bank Securities, Inc.'s Reply Memorandum in Further Support of Motion to Dismiss

and all declarations [*4] and exhibits attached thereto. Following oral argument, the Court announced that it was granting defendants' motions "in total." Upon further reflection, in consideration of all the issues and arguments raised orally and in writing, it is apparent that a complete dismissal is not warranted at this stage. Therefore, the Court makes the following ruling:

IT IS HEREBY ORDERED that plaintiff's RICO, fraud, negligent misrepresentation, breach of contract, declaratory judgment and *Washington Consumer Protection Act* claims will be dismissed with prejudice; his claim of breach of fiduciary duty against defendant KPMG will be dismissed with prejudice as well. The motion to dismiss for lack of personal jurisdiction filed by defendants Presidio Advisory Services, Inc., Deutsche Bank AG and Deutsche Bank Securities, Inc. will be GRANTED. Because those three defendants were only named in regards to causes of action which are being dismissed with prejudice, there is no point in permitting plaintiff to amend and plead sufficient jurisdictional facts as regards them.

IT IS FURTHER ORDERED that the motion is DENIED as to the following: the claim of breach of fiduciary duty against defendant Brown [*5] & Wood, the claim of professional malpractice against defendants KPMG and Brown & Wood, and the claim of conspiracy as it relates to the professional malpractice claim.

IT IS FURTHER ORDERED that plaintiff and the remaining defendants are to conduct initial discovery pursuant to *FRCP 26(f)* and submit a Joint Status Report to the Court by no later than March 26, 2004.

I. Background

Plaintiff has brought a series of RICO and state law claims against a variety of defendants. Some of the defendants have not appeared; some of them have been voluntarily dismissed. Pending before the Court are a series of motions to dismiss brought by the remaining defendants in the action.

In July of 1999, plaintiff realized approximately $ 18 million in profits from the sale of a business. His broker at Merrill Lynch referred him to defendant KPMG (a major accounting firm) for tax planning advice. The strategy they promoted to him was a plan called BLIPS (Bond Linked Issue Premium Structure) which was designed to create artificial economic losses which would offset his capital gains and diminish his tax liability. Prior to entering into the transaction, plaintiff signed a written "engagement letter-agreement" [*6] with KPMG which disclosed the potential risks of the plan and acknowledged that results were not guaranteed.

The transactions comprising the BLIPS plan occurred between September 30 and November 29, 1999. KPMG arranged a line of credit with defendant Deutsche Bank ("DB") in the amount of $ 53 million for a company called Gascoyne LLC (which KPMG had set up for Swartz). Plaintiff claims this was not a true loan (DB had final approval over the use of the funds and required a 1.0125:1 ratio of collateral to loan), although loan fees were charged.

The line of credit was contributed by Gascoyne to a new limited liability company, Longs Strategic Investment Fund ("Longs") -- Swartz was a 90% owner of this company, with defendants Presidio Growth. LLC and Presidio Advisory Services, Inc. ("Presidio") owning the other 10% and exercising control over the fund management. Two foreign currency trades were conducted by Presidio.

On November 30, 1999, Longs was dissolved. A number of shares of Microsoft stock which had been "contributed" by Gascoyne were returned along with tax opinion letters from KPMG and the law firm of defendant Brown & Wood ("B&W" n1) stating that the shares had a basis [*7] equal to any capital contributed to Long's, which had the effect of creating an "artificial short term capital loss."

n1 The firm name was later changed to Sidley Austin Brown & Wood and it was under this name that they were sued.

On December 27, 1999, the IRS issued a notice concluding that the BLIPS tax plan did not produce bona fide deductions for income tax purposes. On September 5, 2000, an additional notice was issued regarding variations on the plans covered in the original notice and expanding the potential penalties for participation in or promotion of such schemes to include criminal liability.

On December 31, 1999, KPMG and B&W issued tax opinions indicating their belief that it was "more likely than not" that BLIPS would be upheld if challenged by the IRS. When plaintiff's original accounting firm withdrew from preparation of his tax returns, KPMG prepared them.

Plaintiff's 2000 tax return (filed in October 2000) claimed the BLIPS transaction as a write-off, despite the fact that (as the complaint [*8] alleges) plaintiff was aware by August 2000 that the claimed deductions were questionable. Plaintiff filed two subsequent tax returns (in 2001 and 2002) in which he had the opportunity to, but did not, amend the claimed BLIPS deduction.

On June 6, 2003, plaintiff initiated this lawsuit with a complaint charging the defendants with violations of RICO and the *Washington Consumer Protection/Unfair*

Business Practices Act, as well as fraud, negligent misrepresentation, breach of contract, professional negligence, breach of fiduciary duty and conspiracy.

The IRS did eventually challenge plaintiff's claim of loss via the BLIPS transaction. Not until after the complaint was filed in this case did they finally disallow the claimed deduction. Although plaintiff has paid the back taxes and accrued interest, he has not alleged that any penalties have been assessed against him. In fact, nowhere has plaintiff alleged that the IRS action against him has been finalized. Other damages alleged by plaintiff include the fees he paid to the various co-defendants, professional fees paid to mitigate the damages which defendants allegedly caused and the money he might have saved if he had tried to mitigate [*9] his tax burden through legitimate means.

II. STANDARD OF REVIEW

[HN1] The Court reviews these motions pursuant to the requirements of *FRCP 12(b)*. All allegations of material fact are taken as true and construed in the light most favorable to the nonmoving party. *Cervantes v. United States, 330 F.3d 1186, 1187 (9th Cir. 2003)*; *Warren v. Fox Family Worldwide, Inc., 328 F.3d 1136, 1139 (9th Cir. 2003)*. [HN2] Conclusory allegations and unwarranted inferences, however, are insufficient to defeat a motion to dismiss. See *Warren, 328 F.3d at 1139*; *Associated Gen. Contractors v. Metropolitan Water Dist. of S. California, 159 F.3d 1178, 1181 (9th Cir. 1998)*; *In re Syntex Corp. Sec. Litig., 95 F.3d 922, 926 (9th Cir. 1996)*. A complaint should not be dismissed unless it appears beyond doubt that the plaintiff can prove no set of facts in support of the claim that would entitle the plaintiff to relief. See *No. 84 Employer-Teamster Joint Council Pension Trust Fund v. American West Holding Corp., 320 F.3d 920, 931 (9th Cir. 2003)*; *In re Zimmer, 313 F.3d 1220, 1222 (9th Cir. 2002)*; *Van Buskirk v. Cable News Network, Inc., 284 F.3d 977, 980 (9th Cir. 2002)*; [*10] *Wyler Summit Partnership v. Turner Broadcasting System, 135 F.3d 658, 661 (9th Cir. 1998)*.

III. DISCUSSION

The defendants alleged multiple grounds for dismissal in their motions. In the case of those claims which the Court finds cannot be rehabilitated through amendment (i.e., there is no conceivable set of facts under which plaintiff could state a claim upon which relief may be granted), the opinion will discuss only those grounds for dismissal which are incurably fatal.

A. RICO CLAIMS

1. Effect of Private Securities Litigation Reform Act

In 1995, Congress amended the RICO statute to eliminate securities fraud as a predicate act upon which to base a RICO claim. Private Securities Litigation Reform Act ("PSLRA") § 107, Pub.L.No. 104-67, 109 Stat. 737 (1995). [HN3] "No person may rely upon any conduct that would have been actionable as fraud in the purchase or sale of securities to establish a violation of *[18 U.S.C.] section 1962*." *18 U.S.C. § 1964(c)*.

[HN4] The rule that a plaintiff cannot assert a RICO claim based on predicate acts that sound in securities fraud is applicable even if, as is the case here, the claim is plead [*11] as a matter of mail fraud or wire fraud. See *Howard v. America Online Inc., 208 F.3d 741, 749-50 (9th Cir. 2000)*, cert. denied, *531 U.S. 828, 148 L. Ed. 2d 40, 121 S. Ct. 77 (2000)*. The exclusion applies even if the RICO plaintiff could not have asserted the securities fraud claim himself. Id.

The distribution of the Microsoft shares following the dissolution of Longs involved, according to plaintiff's complaint, allegedly fraudulent representations by the defendants and therefore is actionable as securities fraud. Plaintiff seeks to characterize the foreign currency transaction which was used to claim the purported loss as outside the bounds of securities law, ignoring [HN5] the definition of "securities" found in *15 U.S.C. § 77b(a)(1)* which includes "any. . . stock" and "any. . . option relating to foreign currency."

That oversight aside, plaintiff's argument that there can be no 10b-5 securities fraud "in connection with" the purchase or sale of a security unless the misrepresentation touches upon a decline in the securities' value (i.e., that the securities themselves must somehow be the object of the alleged fraud) is not supported by case law. [HN6] The Supreme [*12] Court has made it clear that the "in connection with" requirement of 10b-5 is satisfied if "the scheme to defraud and the sale of securities coincide" and that neither the SEC nor the Supreme Court has ever required a misrepresentation about a stock's value in order to activate the statutory prohibitions. (*SEC v. Zandford, 535 U.S. 813, 822, 153 L. Ed. 2d 1, 122 S. Ct. 1899, [2002]*); the Ninth Circuit is in accord (*Walling v. Beverly Enterp's, 476 F.2d 393, 396 [9th Cir. 1973]*).

Plaintiff's attempt to persuade the Court that the PSLRA is inapplicable to this transaction because the sale of the Microsoft stock was somehow "an incidental attribute of the fraud" (Plaintiff's Opposition to KPMG Motion, p. 12) is unavailing. From plaintiff's own description of the scheme in his complaint, the sale of the securities was clearly central to the intended result; i.e., without the sale of the Microsoft stock, there would have been no corresponding loss to offset his capital gains. It is evident that this alleged fraud was "in connection

with" the sale of securities and therefore within the purview of 10b-5 and the PSLRA.

In a case nearly identical to the one before this Court, a Florida [*13] federal district court found that the plaintiff's RICO claims were likewise barred by the PSLRA. *Loftin v. KPMG et al., 2002 U.S. Dist. LEXIS 26909, 2003 WL 2222562, 116 Fla. L. Weekly Fed D 712 (S.D. Fla Sept. 10, 2003)*. The court there found that [HN7] the fact that "the alleged misrepresentations were unrelated to the value of the securities [did] not foreclose application of the PSLRA bar," nor did the fact that the defendants themselves were not issuers of the securities. *2002 U.S. Dist. LEXIS 26909, [WL] at *11.*

[HN8] The Ninth Circuit has also applied 10b-5 to securities transactions marketed as "tax shelters" and held that the PSLRA barred a RICO suit where plaintiffs were neither buyers or sellers of the stock (*Howard v. AOL, supra*). Plaintiff disagrees with the Howard holding but has not argued that it is not binding precedent on this Court. The Eleventh and Eighth Circuits are in accord: misconduct which induces plaintiffs to engage in a stock transaction (regardless of whether they would have standing to sue for securities fraud) satisfies the "in connection with" requirement. *Behlen v. Merrill Lynch, 311 F.3d 1087 (11th Cir. 2002)*; *Dudek v. Prudential Secs., Inc., 295 F.3d 875 (8th Cir. 2002)*. [*14]

The end result of these line of cases is inescapable: the sale of plaintiff's Microsoft stock in connection with this allegedly fraudulent tax shelter scheme brings it squarely within the ambit of a cause of action for securities fraud, thereby rendering it ineligible to be prosecuted pursuant to the statutory scheme of RICO.

2. No Fraud in the Absence of Reasonable Reliance

Plaintiff has predicated his RICO claim on mail and wire fraud; [HN9] an essential element of fraud is proof of reasonable reliance on allegedly fraudulent statements. See *Sikes v. Teleline, Inc., 281 F.3d 1350, 1360-61 (11th Cir. 2002)*; *Summit Props., Inc. v. Hoechst Celanese Corp., 214 F.3d 556, 560, 562 (5th Cir. 2000)*; *Metromedia. Co. v. Fugazy, 983 F.2d 350, 368 (2nd Cir. 1992)*; *Martin v. Dahlberg, Inc., 156 F.R.D. 207, 215 (N.D. Cal. 1994)*. Plaintiff alleges oral misrepresentations from defendants regarding the outcome of the BLIPS strategy, but such representations cannot establish reasonable reliance as a matter of law where there are written documents which contradict any oral statements. See *Zobrist v. Coal-X, Inc., 708 F.2d 1511, 1518-19 (10th Cir. 1983)*; [*15] *Townsend v. Columbia Operations, 667 F.2d 844, 850 (9th Cir. 1982)*; *Moniz v. General Motors Corp., 2000 U.S. Dist. LEXIS 13827, 2000 WL 1375285, at *5 (N.D. Cal. 2000)*, aff'd without opinion, *23 Fed. Appx. 855, 2002 WL 22343 (9th Cir. 2002)*.

The complaint acknowledges that plaintiff was advised of the possibility of an audit. Complaint, P40. This advisement took the form of an "engagement letter," presented by KPMG and signed by an agent of plaintiff, which enumerated in detail the risks of participating in the BLIPS scheme. The letter indicated that this strategy was "aggressive in nature" and involved the possibility of a successful IRS challenge ("the [IRS] might challenge the intended results of the Investment Program and could prevail under any of various tax authorities"). Declaration of Ward, Exh. 1. As a matter of law, plaintiff cannot establish reasonable reliance in the face of such a document. [HN10] The Ninth Circuit has already held that a plaintiff who enters into a transaction knowing that there are a range of possible outcomes cannot state a RICO claim simply because he received a less favorable outcome within the stated range. *Chaset v. Fleer/Skybox Int'l, LP, 300 F.3d 1083, 1087 (9th Cir. 2002)*. [*16]

Plaintiff claims that a "non-disclosure" provision in the engagement letter prevented him from discussing the details of the strategy with a third party, but defendants point out that the provision only required plaintiff to obtain their consent before initiating such a discussion. Plaintiff does not allege, in his complaint or his briefing, that he ever requested such consent.

Furthermore, plaintiff is not entitled to rely on KPMG's "promise" that it would deliver tax opinion letters from itself and B&W; [HN11] such a promise is not a "representation of an existing fact" and cannot form the basis for a fraud claim. *Stiley v. Block, 130 Wn.2d 486, 505-06, 925 P.2d 194 (1996)*; *Micro Enhancement Int'l, Inc. v. Coopers & Lybrand, LLP, 110 Wn.App. 412, 436, 40 P.3d 1206 (2002)*.

Finally, it is evident from the face of the complaint itself that, prior to filing his initial post-BLIPS tax return in October of 2000, plaintiff was aware that his accountant (Moss Adams) had called his entire tax reduction strategy into question. He received the B&W opinion letter in December of 1999. Complaint P54. On August 25, 2000, his accountants sent him a letter "questioning the validity and legitimacy [*17] of the tax opinions provided to [plaintiff] by KPMG and Brown & Wood," advising him of the contents of *IRS Notice 2000-44* and offering their opinion that the IRS would not consider the BLIPS transactions to constitute a bona fide loss. Complaint PP64-65. His accountant then resigned on October 10, 2000 based on its belief that the tax returns were invalid. Complaint P67. Nowhere in plaintiff's briefing is there an explanation of how he reasonably relied on any alleged misrepresentations by defendants in the wake of this information.

Additionally, as described in plaintiff's complaint, he received a letter from defendant KPMG advising him

that the anticipated BLIPS tax advantages "might be disallowed by the IRS." Complaint P68. Not only did he file his 2000 tax return claiming the BLIPS transactions as a deduction anyway, he filed returns in 2001 and 2002 without amending that claim. Plaintiff cannot, as a matter of law, establish the critical fraud requirement of reasonable reliance in the face of such facts.

B. FRAUD

The analysis above regarding the absence of reasonable reliance in plaintiff's pleading of fraud as a predicate to his RICO claim is equally applicable to his [*18] cause of action for fraud. The Court finds that the failure to establish that plaintiff reasonably relied on any allegedly fraudulent misrepresentations by defendants is fatal to Count 3 of his complaint as well, and that there are no conceivable set of facts plaintiff could plead which would establish a claim upon which the Court could grant relief.

C. WASHINGTON CONSUMER PROTECTION ACT

[HN12] A successful *Consumer Protection Act* ("CPA") claim requires the establishment of the following elements: (1) an unfair or deceptive act or practice; (2) occurring in trade or commerce; (3) affecting the public interest; (4) that injures the plaintiff in his or her business or property; and (5) a causal link between the unfair or deceptive act and the injury suffered. *Hangman Ridge Training Stables, Inc. v. Safeco Title Ins. Co., 105 Wn.2d 778, 719 P.2d 531 (1986)*. Plaintiff is unable to state a claim under two of these five elements.

1. No "capacity to deceive"

[HN13] An act or practice is "unfair or deceptive" under the CPA only if it has the capacity to deceive "a substantial portion" of the public. *Henery v. Robinson, 67 Wn.App. 277, 289-91, 834 P.2d 1091 (1992)*. The number of consumers [*19] who could conceivably find themselves in plaintiff's circumstances -- looking for a tax savings on millions of dollars of capital gains -- is extremely small and unable to qualify as "a substantial portion of the public" under any reasonable definition of that term. As a matter of law, conduct directed toward a small group cannot support a CPA claim. *Id. at 291*; see also *Micro Enhancement, 110 Wn.App. at 438-439*.

2. The public interest is not affected

For reasons similar to those stated above, plaintiff cannot establish that his dilemma is one which affects the public interest. [HN14] The tribulations of multimillionaires are not the focus of the legislative intent behind the CPA; as a (very small) group, the extremely wealthy are neither unsophisticated nor easily subject to chicanery. See *Goodyear Tire & Rubber Co. v. Whiteman Tire, Inc., 86 Wn.App. 732, 935 P.2d 628 (1997)*, where a CPA claim was dismissed on public interest grounds based on a finding that the plaintiff was "not representative of bargainers vulnerable to exploitation." *Id. at 745*.

There being no conceivable set of facts under which plaintiff could satisfy either [*20] of these elements, his claim under the Washington CPA must be dismissed.

D. BREACH OF CONTRACT

Plaintiff alleges at Count 5 of his complaint that defendants KPMG and B&W breached oral and written contracts with him "to provide. . . professionally competent tax advice, legal services, accounting services and tax return preparation services, to exercise the applicable standard of care, loyalty and honesty and to comply with all applicable rules of professional contact [sic]."

B&W point out that [HN15] Washington law holds that "legal malpractice is not a liability express or implied arising out of a written agreement unless the agreement guarantee[s] a specific result or assures[s] the effect of legal services." *Davis v. Davis, Wright, Tremaine, LLP, 103 Wn.App. 638, 650, 14 P.3d 146 (2000)*, citing *Busk v. Flanders, 2 Wn.App. 526, 530, 468 P.2d 695 (1970)*. The complaint does not allege that the contract guaranteed a result; any promises to provide "professionally competent. . . advice [and] services" or "to exercise the applicable standard of care..." are therefore nothing more than "implied duties of counsel to client that do not arise from [a] contract." *Id.* [*21] *at 655*.

Plaintiff's rebuttal to this argument -- that B&W are liable on a contract theory as the agent of defendant KPMG -- is puzzling to say the least. [HN16] "An agent, by making a contract only on behalf of a competent disclosed or partially disclosed principal... does not thereby become liable for its nonperformance." *Rest. 2d, Agency § 328*. An agent is not liable for the contractual duties of its principal. The breach of contract claim will be dismissed as to B&W.

As regards defendant KPMG, the breach of contract allegations amount to nothing more than the re-framing of a negligence or malpractice claim against the accounting firm: violation of a duty of care owed from a professional to a client. The engagement letter did not specifically promise any of the things that plaintiff is alleging as breaches of contract and in fact promised no specific result at all. Given the known facts, there is no conceivable set of circumstances under which plaintiff could state a claim for breach of contract against KPMG under which relief could be granted. That cause of action will be dismissed against KPMG as well.

E. DECLARATORY JUDGMENT

Plaintiff's claim for declaratory judgment (Count [*22] 6) will likewise be dismissed with prejudice. Obviously, as regards the dismissed defendants, the issue of a declaratory judgment is a nullity. Similarly, to the extent that plaintiff seeks a declaration that any tax penalties which he might be assessed in the future are the responsibility of defendant, his claim is subject to dismissal pursuant to *12(b)(6)*. [HN17] In order to maintain a claim under the *Declaratory Judgment Act*, "a plaintiff must establish standing by showing 'that there is a substantial controversy, between parties have adverse interest, of sufficient immediacy and reality to warrant issuance of a declaratory judgment.'" *Scott v. Pasadena Unified School District, 306 F.3d 646, 658 (9th Cir. 2002)*; see also *Aydin Corp. v. Union of India, 940 F.2d 527, 529 (9th Cir. 1991)*. A declaratory judgment is "not ripe for adjudication if it rests upon 'contingent future events that may not occur as anticipated, or indeed may not occur at all.'" *Hodgers-Durgin v. De La Vina, 199 F.3d 1037, 1044 (9th Cir. 1999)* [quoting *Texas v. United States, 523 U.S. 296, 300, 140 L. Ed. 2d 406, 118 S. Ct. 1257 (1998)]*. Any assessment of penalties against the plaintiff [*23] by the IRS remains a future event which may not occur as anticipated, if at all. n2

> n2 The Court notes that the loss of the value of whatever benefits Swartz was to have received from the BLIPS transaction is not compensable in any event. See *Volk v. D.A. Davidson & Co., 816 F.2d 1406, 1415 (9th Cir. 1987)* (no RICO claim for disallowed tax shelter); and *Jones v. Childers, 1992 U.S. Dist. LEXIS 19430, 1992 WL 300845, at *23 (M.D.Fla. 1992)*, aff'd in part, rev'd in part, *18 F.3d 899 (11th Cir. 1994)* (back taxes are just money owed based on income, "not damages proximately caused by the actions of the Defendants.").

As for the remainder of that cause of action, it appears to this Court that the request is merely duplicative of his request for damages for the other causes of action. His request for a "declaration that Defendants are liable to Swartz for such penalties, interest, professional fees, and damages" (Complaint P109) is puzzling. If defendants are found liable, damages will be assessed [*24] according to the proof adduced by plaintiff; if plaintiff does not prevail on his other causes of action, there will be no judgment, declaratory or otherwise, forthcoming in his behalf. His request that the KPMG engagement letter be declared void and unenforceable (Complaint, P110) is completely lacking in any citation to statutory or case authority or any other legal basis on which the requested relief might be granted.

The above causes of action (RICO, fraud, Washington Consumer Protection Act and breach of contract) will be dismissed with prejudice against all defendants; i.e., plaintiff will not be given an opportunity to amend his complaint. The Court has determined that, as regards those claims, [HN18] plaintiff could not allege any set of facts consistent with the facts already before the Court which could possibly cure the defects of his pleading and, on that basis, leave to amend will not be granted. See *Schreiber Dist. v. Serv-Well Furniture Co., 806 F.2d 1393, 1401 (9th Cir. 1986)*; *Doe v. United States, 58 F.3d 494, 497 (9th Cir. 1995)*. Since dismissal of the above-cited claims eliminates all defendants but KPMG and B&W (and their associated individual [*25] defendants, Baumann and Ruble), the civil conspiracy and declaratory judgment claims against all other defendants will be dismissed with prejudice as well.

F. BREACH OF FIDUCIARY DUTY

[HN19] The existence of a fiduciary relationship is not simply a matter of "reposing trust and confidence in the integrity of another. . . There must be additional circumstances, or a relationship that induce the trusting party to relax the care and vigilance which he would ordinarily exercise for his own protection." *Moon v. Phipps, 67 Wn.2d 948, 954, 411 P.2d 157 (1966)*. When the parties are dealing with each other "at arm's length," the "special circumstances" which give rise to a fiduciary relationship do not exist. *Tokarz v. Frontier Federal Savings and Loan Ass'n, 33 Wn.App. 456, 463-64, 656 P.2d 1089 (1982)*.

Plaintiff argues that the allegations that KPMG "sought and obtained [his] confidence" and then obtained a non-disclosure agreement from him comprise sufficient pleadings to establish a fiduciary duty. But, as plaintiff alleges in his own complaint, KPMG did not "seek him out," rather he was referred to them by his broker at Merrill Lynch. Complaint, P32. Nor does plaintiff ever controvert [*26] defendants' assertion that he never requested consent of the defendants to consult a third party as he was entitled (and advised) to do under the agreement.

None of the facts before this Court suggest anything other than an arm's-length bargaining relationship between these parties, nor are there any conceivable set of facts which plaintiff could plead that would establish the possibility that a multimillionaire with $ 18 million in capital gains could find himself in an unequal bargaining position with a tax adviser. Count 2 alleging a breach of fiduciary duty on the part of defendant KPMG is hereby dismissed.

B&W did not address, either in its written pleadings or in oral argument before the Court, the issue of whether plaintiff had a viable claim for breach of fiduciary duty

against them. They do argue, generally, that all of plaintiff's claims fail for lack of causation on the grounds that plaintiff had already engaged in the BLIPS transaction by the time that B&W issued its two letters to him. This argument is not persuasive, primarily because the point at which plaintiff was injured, if at all, occurred when he filed his 1999 income tax return in October 2000 claiming the BLIPS [*27] transaction as a bona fide loss for tax purposes. This took place well after B&W's initial opinion letter had been delivered. Since [HN20] it is a common practice for plaintiffs to plead both legal malpractice and breach of fiduciary duty against attorney-defendants [see *O'Melveny & Myers v. F.D.I.C., 512 U.S. 79, 114 S. Ct. 2048, 129 L. Ed. 2d 67 (1994)*; *Old Oakland Partnership I v. Lukens, 188 F.3d 514 (9th Cir. 1999)]* and B&W has made no other argument that the claim is deficient pursuant to *12(b)(6)*, the claim for breach of fiduciary duty against B&W will not be dismissed.

G. NEGLIGENT MISREPRESENTATION/PROFESSIONAL MALPRACTICE

Plaintiff's claim in Count 4 that defendants KPMG and B&W are liable for negligent misrepresentation and professional malpractice runs afoul of some of the same problems as his claims sounding in fraud. [HN21] Negligent misrepresentation, like fraud, requires a showing of reliance. *Schaaf v. Highfield, 127 Wn.2d 17, 22, 896 P.2d 665 (1995)*. As discussed above, there is no conceivable set of facts which plaintiff could adduce which would create a possibility of establishing reasonable reliance based on the evidence already before [*28] the Court, and KPMG and B&W are entitled to a dismissal of this cause of action.

KPMG argues for dismissal of the professional malpractice claim against it based on the engagement letter signed by plaintiff which indemnifies them "from and against any and all losses, claims, damages and liabilities . . . except to the extent caused by gross negligence or intentional misconduct of KPMG." Declaration of Ward, Exh. 1, p. 4. All plaintiff's allegations are framed in the alternative ("knowingly or negligently," "knew or should have known"), and the Court finds that, taking the allegations of material fact as true and construing them in the light most favorable to plaintiff, it is conceivable that plaintiff could prove a set of facts which would constitute intentional misconduct amounting to professional malpractice (i.e., a violation of the reasonable standard of care expected of all practitioners in the field of accounting). The claim for professional malpractice against KPMG will be permitted to stand.

Again, B&W did not address the legal malpractice claim in its briefing or oral argument, except for the generic "lack of causation" argument which has been disposed of supra. Therefore, [*29] Count 4, the professional malpractice claim against the defendant-law firm, will not be dismissed.

H. CIVIL CONSPIRACY

At Count 8 of his complaint, plaintiff has alleged a civil conspiracy involving all defendants. [HN22] A civil conspiracy is "a combination of two or more persons to commit a criminal or unlawful act, or to commit a lawful act by criminal or unlawful means." *Harrington v. Richeson, 40 Wn.2d 557, 573, 245 P.2d 191 (1952)* A properly plead conspiracy "must set forth with particularity the facts and circumstances constituting the alleged conspiracy." *Heying v. Simonaitis, 126 Ill. App. 3d 157, 466 N.E.2d 1137, 1142, 81 Ill. Dec. 335 (Ill.App.Ct. 1984)*. Conclusory statements will not suffice to state a conspiracy claim. *Reo v. Shudt, 144 A.D.2d 793, 795, 534 N.Y.S.2d 553 (N.Y.App.Div. 1988)*.

A "claim for civil conspiracy is entirely dependent on underlying" substantive claims; where "the underlying claims fail, [the] civil conspiracy claim must also fail." *Oregon Laborers-Employers Health & Welfare Trust Fund v. Phillip Morris, 185 F.3d 957, 969 (9th Cir. 1999)*. Therefore no conspiracy cause of action will lie for the dismissed claims. And, as B&W is the only defendant remaining in the [*30] count charging breach of fiduciary duty, no conspiracy allegation is possible regarding that charge, either. The Court will, however, permit the conspiracy count to remain as regards the allegations of professional malpractice which are still extant against defendants KPMG and B&W.

I. PERSONAL JURISDICTION

[HN23] It is plaintiff's burden to establish that personal jurisdiction over the named defendants exists. *Scott v. Breeland, 792 F.2d 925, 927 (9th Cir. 1986)*. Defendants Presidio, Deutsche Bank AG and Deutsche Bank Securities, Inc. have all challenged plaintiff's complaint on the grounds that it fails to establish personal jurisdiction, asserting that Swartz has failed to allege any facts sufficient to establish minimum contacts within this forum sufficient to justify the exercise of personal jurisdiction.

In rebuttal, plaintiff alleges, without citation to particular facts in his complaint or to other evidence, that he has "alleged sufficiently" that these defendants are subject to the Court's general jurisdiction. In the face of defendants' disputation, he requests leave to take "jurisdiction-specific" discovery to establish the existence of jurisdiction.

[HN24] It [*31] is not acceptable for a plaintiff to hale a party into court, then ask leave to conduct discovery to establish that he had a right to do so. If plaintiff

had no more than the overbroad, conclusory allegations with which he attempts to justify the exercise of jurisdiction over these parties, they should never have been joined as defendants. The Court finds that there is insufficient basis to establish personal jurisdiction over defendants Presidio, Deutsche Bank AG and Deutsche Bank Securities and dismisses them on that basis.

In any event, all the causes of action for which defendants Presidio, Deutsche Bank AG and Deutsche Bank Securities were alleged to have been liable have been dismissed. Ultimately, the issue of whether this Court has personal jurisdiction over them is moot.

IV. Conclusion

Plaintiff has failed to state a claim upon which relief can be granted on his claims of RICO violations, fraud, negligent misrepresentation, Washington CPA violations and breach of contract. There being no conceivable set of facts under which relief could be granted, the dismissal will be with prejudice. This has the effect of dismissing all the remaining defendants from this case [*32] except KPMG and B&W (and their individual defendants, Dale R. Baumann and R.J. Ruble).

As regards the remaining defendants, the allegation of breach of fiduciary duty will be dismissed with prejudice against KPMG, as plaintiff can allege no set of facts under which relief could be granted against that defendant. The cause of action for professional malpractice will be allowed to stand against both KPMG and B&W, as will the conspiracy allegation as regards that claim.

Plaintiff and the remaining defendants are ordered to conduct initial discovery pursuant to *FRCP 26(f)* and submit a Joint Status Report to the Court by no later than March 26, 2004.

The clerk is directed to provide copies of this order to all counsel of record.

Dated: February 13, 2004

Marsha J. Pechman

United States District Judge

Tab 4

Westlaw.

Not Reported in N.E.2d
Not Reported in N.E.2d, 18 Mass.L.Rptr. 287, 2004 WL 2341344 (Mass.Super.)
(Cite as: 2004 WL 2341344 (Mass.Super.))

Superior Court of Massachusetts.
James R. YOUNG, as Trustee of the NutraMax Litigation Trust
v.
DELOITTE & TOUCHE, LLP.
No. 040807BLS.

Sept. 20, 2004.

MEMORANDUM AND ORDER ON MOTION TO DISMISS THE THIRD AMENDED COMPLAINT

ALLAN VAN GESTEL, Justice.

***1** This matter is before the Court on a motion by the defendant, Deloitte & Touche LLP ("Deloitte"), pursuant to Mass.R.Civ.P. Rules 9(b) and 12(b)(6), [FN1] to dismiss the Third Amended Complaint. The motion originally was filed in the United States District Court for the District of Massachusetts. On February 25, 2004, and before argument on the motion, the case was transferred to this Court following the dismissal of some, and withdrawal thereafter of the remaining, federal securities law claims.

FN1. The motion, when originally filed, cited the cognate Federal Rules of Civil Procedure.

The plaintiff, James R. Young, is Trustee (the "Trustee") of the NutraMax Litigation Trust (the "Trust"). The Trust is an entity established as part of the NutraMax bankruptcy Plan of Reorganization for the purpose of pursuing litigation relating to NutraMax. The Trustee now has further withdrawn, with prejudice, the state law claims of hundreds of shareholders of NutraMax Products, Inc. ("NutraMax"). Thus, at this time, the Trustee is asserting only the remaining claims of NutraMax, certain identified creditors of NutraMax, and 15 specific NutraMax shareholders.

This is said to be the fifth attempted complaint against Deloitte in connection with the matters in issue. Allegedly, it is the fourth complaint filed by the Trustee. The so-called Third Amended Complaint makes a mockery of both the Fed.R.Civ.P. Rule 8(a)(1) and Mass.R.Civ.P. Rule 8(a)(1) requirements that it contain a short and plain statement of the claim. It is 63 pages long, contains 149 separate numbered paragraphs, many with multiple sub-paragraphs, almost all of which are repeated and re-alleged in preface to each of the four "causes of action" pled. Many of the paragraphs read more like a legal brief and closing arguments than the kind of notice pleading mandated, even accepting the pleading particularity required for some of the claims presented.

BACKGROUND

NutraMax is a private-label health and personal care products company based in Gloucester, Massachusetts. NutraMax filed for bankruptcy on May 2, 2000, and on February 6, 2001, re-emerged as a privately-held corporation.

Deloitte was the former independent auditor of NutraMax. It issued unqualified audit opinions with respect to NutraMax's financial statements for fiscal years ended September 30, 1995, September 28, 1996, September 27, 1997, and October 3, 1998. [FN2]

FN2. The Court is uncertain why Deloitte's letters for each of the years in issue suggest that NutraMax's fiscal year ended on slightly different dates, rather than on the more customary final day of the last month of the fiscal year. Nothing turns on this point.

The Third Amended Complaint alleges that in 1995 three NutraMax officers--its President and CEO, its Vice President and CFO, and its Controller (the "Officers")--"falsified NutraMax's financial statements in many material respects." The complaint does not allege that the Officers did so for their own personal purposes, but rather "to misrepresent NutraMax's financial performance and condition."

The essence of the Trustee's allegations is that "if Deloitte had not ignored the numerous 'red flags' that signaled the problems that ultimately produced [NutraMax's bankruptcy] ... the NutraMax Board of Directors would have learned about the problems when there was still time to correct them without calamitous effect."

***2** The Third Amended Complaint concedes, however, that

"for fiscal years 1995 through 1998, Deloitte met with NutraMax's Audit Committee" and in each year communicated to it in writing that Deloitte had noted certain matters, or "reportable conditions," relating to NutraMax's system for internal accounting controls that needed to be addressed by the Company. The letters for 1995, 1996 and 1997 each included language to the following effect: [FN3]

> FN3. What is included here is the language taken from the Deloitte letter to the Audit Committee dated November 3, 1995.

> In planning and performing our audit of the consolidated financial statements of NutraMax Products, Inc. (the "Company") for the year ended September 30, 1995 (on which we have issued our report dated November 3, 1995), we considered its internal control structure in order to determine our auditing procedures for the purposes of expressing an opinion on the consolidated financial statements and not to provide assurance on the internal control structure. However, we note certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the Company's ability to record, process, summarize, and report financial data consistent with the assertions of management in the consolidated financial statements. The reportable conditions that we noted are described below.

The Third Amended Complaint describes in detail the contents of those letters, and claims that the observations by Deloitte were the "red flags" which should have put Deloitte on notice of possible accounting fraud. The Third Amended Complaint acknowledges that during the 1995 through 1998 period Deloitte warned NutraMax's Audit Committee that, among other things:

> the Company was improperly valuing inventory;
> the Company lacked controls and procedures sufficient to maintain acceptably accurate inventory records;
> the Company was in default under certain loan agreements because it had misstated the value of accounts receivable that were to be included in the computation of the Company's permitted borrowing base;
> the Company was failing to accurately accrue for year-end bonuses as required by GAAP; and
> the Company had no documented accounting policies and procedures, including policies regarding monthly and quarterly reporting; inventory costing; spare parts inventory; purchasing and related authorizations; cash management; credit and collection; computation of allowances for doubtful accounts and related bad debt write-offs; fixed asset capitalization and depreciation; and business conduct.

As noted in the foregoing letters, Deloitte informed NutraMax, year after year, that while it had considered the Company's internal control structure to determine auditing procedures, the Company's failure to correct the deficiencies could adversely affect the Company and the accuracy of its financial reporting. Also, Deloitte made specific recommendations about how to correct the problems.

***3** At the same time, Deloitte also informed NutraMax, year after year, that its audits provided reasonable assurance that NutraMax's consolidated financial statements were free of material misstatements and fairly presented in all material respects NutraMax's financial position and results of its operations.

The Trustee in his memorandum in opposition to the present motion includes the following statements:

> The Complaint alleges that, although Deloitte discovered certain reportable conditions and disclosed them to NutraMax's Audit Committee, it failed to employ audit procedures designed to assess the effects of those reportable conditions on the Company's real financial health and to satisfy itself that NutraMax's financial data did not contain errors, despite representations that Deloitte would do so. Nonetheless, Deloitte specifically reassured NutraMax's Audit Committee, as well as investors and lenders, that its audits complied with professional standards and that the financial statements it certified were based on GAAP.

The several problems with NutraMax's financial condition did not come to light until 1999, after the Board of directors

engaged a new CFO. On November 12, 1999, Deloitte formally withdrew its audit reports with respect to NutraMax's 1996, 1997, and 1998 financial statements.

The Third Amended Complaint contains no allegations that NutraMax took any steps to investigate or address the reportable conditions and other matters identified by Deloitte, or to implement Deloitte's recommendations. According to the Third Amended Complaint, however, at the same time that the NutraMax Audit Committee was receiving and ignoring Deloitte's warnings, NutraMax's management was engaging in accounting fraud by exploiting the very internal control weaknesses that Deloitte had identified.

Three of the 15 identified shareholders for whom the claims are being brought by the Trustee, including the largest shareholder, and who claim to have been misled by Deloitte, held seats on the Board of Directors and the Audit Committee, and presumably were aware of Deloitte's communications.

The Third Amended Complaint contains no allegations of the existence of any privity between Deloitte and any of the shareholders or creditors of NutraMax, nor does it allege that Deloitte had actual knowledge that each of those shareholders and creditors would rely on its statements. Nor is there any allegation that any of the claimants actually read and relied on Deloitte's audit reports.

The claims in the Third Amended Complaint charge Deloitte with common-law fraud, negligent misrepresentation, violation of G.L.c. 93A and professional malpractice. It is significant to note that this is not a class action, nor is it a shareholder's derivative suit. Rather, the Trustee speaks in apparently multiple tongues for each individual shareholder and creditor, as well as for the NutraMax corporation, whose several individual claims were assigned to the Trust by order of the bankruptcy court.

DISCUSSION

***4** A Rule 12(b)(6) motion admits all well-pleaded allegations of the Third Amended Complaint, and the Court must accept as true such inferences as may be drawn in the Trustee's favor. *Fairneny v. Savogram Co.*, 422 Mass. 469, 470 (1996); *Natick Auto Sales, Inc. v. Department of Procurement and General Services*, 47 Mass.App.Ct. 625, 630 (1999). Of course, conclusions of law from the facts alleged are open for review on a Rule 12(b)(6) motion. The claims here, however, are sufficient to survive under Rule 12(b)(6) unless they show beyond doubt that no provable set of facts would entitle the Trustee to relief. *Harvard Law School Coalition for Civil Rights v. President & Fellows of Harvard College*, 413 Mass. 66, 68 (1992). The Trustee bears a "relatively light burden," *Warner-Lambert Co. v. Execuquest Corp.*, 427 Mass. 46, 47 (1998), and must be given the benefit of any doubts. *Kipp v. Keuker*, 7 Mass.App.Ct. 206, 210 (1979).

Indeed, as the Supreme Judicial Court, when discussing its own duties regarding a motion to dismiss, has so recently reminded this particular Court:

> The standard of review for a motion to dismiss pursuant to Rule 12(b)(6) is well settled. We take as true " 'the allegations of the complaint, as well as such inferences as may be drawn therefrom in the plaintiff's favor ...' *Blank v. Chelmsford Ob/Gyn, P.C.*, 420 Mass. 404, 407 (1995). In evaluating the allowance of a motion to dismiss, we are guided by the principle that a complaint is sufficient 'unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.' *Nader v. Citron*, 372 Mass. 96, 98 (1977), quoting *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957)." *Warner-Lambert Co. v. Execuquest Corp.*, 427 Mass. 46, 47 (1998). Although errors of law based on the facts alleged will not surmount a rule 12(b)(6) challenge, the plaintiff's burden is "relatively light." *Id.*, citing *Gibbs Ford, Inc. v. United Truck Leasing Corp.*, 399 Mass. 8, 13 (1987). Under the "generous principles" governing our review ..., *Connerty v. Metropolitan Dist. Comm'n*, 398 Mass. 140, 143 (1986), we summarize the facts alleged in the ... complaint and in uncontested documents of record. *Marram v. Kobrick Offshore Funds, Ltd.*, 442 Mass. 43, 45 (2004).

Here, of course, in assessing the third amended complaint, this Court is not addressing a *tabula rasa*. Other courts, assessing earlier incarnations of the Trustee's claims, have found many of those claims to be wanting. Nevertheless,

this Court has a duty to decide on its own, based on what it is that is before it.

First, the Court observes that it, unlike prior courts, is addressing a complaint making only Massachusetts state law claims. No Federal claims are before it.

Second, there are two rather distinct and separate claimants or groups of claimants--the 15 shareholders and the creditors, on the one hand, and NutraMax itself on the other hand--and the law is somewhat different with regard to these two claimants. [FN4]

> FN4. For purposes of this discussion, the Court will treat the group of claimants made up of the shareholders and the creditors as one claimant and NutraMax as the other claimant.

***5** The Court will deal with the claims against the shareholders and creditors separately from the claims against NutraMax itself.

Claims Brought by the Shareholders and Creditors

Fraud and negligent misrepresentation.

In the First Cause of Action the shareholders and creditors group charge Deloitte with common-law fraud, and in the Second Cause of Action they charge Deloitte with negligent misrepresentation. Mass.R.Civ.P. Rule 9(b) "requires that allegations of fraud and deceit must be pleaded with particularity." *Equipment & Systems for Industry, Inc. v. Northmeadows Construction Co, Inc.*, 59 Mass.App.Ct. 931 (2003). "At a minimum, [the Trustee] alleging fraud must particularize ... the contents of the misrepresentation, and where and when it took place. In addition the [Trustee] should specify the materiality of the misrepresentation, ... reliance thereon, and resulting harm." *Id.* at 931-32. See also *Friedman v. Jablonski*, 371 Mass. 482, 488-89 (1976).

"As with fraud, a claim of negligent misrepresentation requires plaintiffs to plead reliance with particularity." *Sebago, Inc. v. Beazer East, Inc.*, 18 F.Sup.2d 70, 95 (D.Mass.1998).

In each of paragraphs 117 and 119 of the First Cause of Action, and paragraph 130 of the Second Cause of Action, it is alleged that the shareholders or the creditors, as the case may be, "justifiably relied upon Deloitte's false statements and misrepresentations" in taking certain action. This is enough at this stage of the case. See *Friedman, supra*, 371 Mass. at 488-89; *Cardone v. Perez*, 57 Mass.App.Ct. 1103 (2003) (pursuant to Rule 1:28).

It is true, however, that, as Deloitte points out, there are no allegations demonstrating any individualized reliance by any single shareholder or creditor. See *Brockton Savings Bank v. Peat, Marwick, Mitchel & Co.*, 577 F.Sup. 1281, 1287 (D.Mass.1983) (dismissing fraud and negligent misrepresentation claims where plaintiff failed to "allege in any way that it read, received or even knew of the" alleged misrepresentations prior to its purchase of securities). Discovery may reveal in detail the presence or absence of reliance for each individual shareholder and creditor involved. Motions under Rule 56 can more properly bring these issues before the Court. See, e.g., *In re Bank of Boston Corp. Sec. Litig.*, 762 F.Sup. 1525, 1536 (D.Mass.1991). For purposes of assessing the Third Amended Complaint on a motion to dismiss, this Court cannot rule that there was a decisive failure in pleading on the issue of reliance.

There is a reference in paragraph 113 of the Third Amended Complaint that sounds somewhat like a claim for fraud on the market. No case has been brought to the attention of this Court, nor has it found any itself holding that Massachusetts common law applies the fraud-on-the-market doctrine to fraud or negligent misrepresentation claims. Indeed, the Trustee seems to concede as much, albeit somewhat obliquely. See Trustee's memorandum in opposition at p. 8. This trial Court, however, is not the place where new causes of action or claims of this nature should be spawned. Thus, to the extent or degree that the First or Second Causes of Action are predicated on a fraud-on-the-market theory they must, in that limited regard, be dismissed.

***6** Before leaving the First and Second Causes of Action, the Court next considers the teachings of *Nycal Corp. v. KPMG Peat Marwick LLP*, 426 Mass. 491 (1998). In *Nycal*, the Supreme Judicial Court addressed for the first time "the scope of liability of an accountant to persons with whom the accountant is not in privity." *Id.* at 493. In doing so, it adopted a test taken from Sec. 552 of the Restatement (Second) of Torts. *Id.* at 497-98.

Sec. 552 describes the tort of negligent misrepresentation committed in the process of supplying information for the guidance of others as follows:

> One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

That liability is limited to

> loss suffered (a) by a person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and (b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.

The SJC, *id.* at 497, particularly adopted comment h to Sec. 552 of the Restatement, which reads as follows:

> [I]t is not required that the person who is to become the plaintiff be identified or known to the defendant as an individual when the information is supplied. It is enough that the maker of the representation intends it to reach and influence either a particular person or persons, known to him, or a group or class of persons, distinct from the much larger class who might reasonably be expected sooner or later to have access to the information and foreseeably to take some action in reliance upon it ... It is sufficient, in other words, insofar as the plaintiff's identity is concerned, that the maker supplies the information for repetition to a certain group or class of persons and that the plaintiff proves to be one of them, even though the maker never had heard of him by name when the information was given. It is not enough that the maker merely knows of the ever-present possibility of repetition to anyone, and the possibility of action in reliance upon it, on the part of anyone to whom it may be repeated.

In *Nycal,* the SJC concurs with the California Supreme Court's holding in *Bily v. Arthur Young & Co.*, 3 Cal.4th 370, 394, 834 P .2d 745, 769 (1992), that Sec. 552 appropriately recognizes the commercial realities in play. *Id.* at 497. In *Bily,* the California court spoke of both negligent misrepresentations and "intentional fraud in the preparation and dissemination of an audit report." *Bily, supra,* 834 P.2d at 747.

***7** As noted at the beginning of this memorandum, the Third Amended Complaint takes a blunderbuss approach to the situation. It is not, therefore, readily digestible for a Court when ruling on a motion to dismiss. [FN5] Consequently, the Court may, in its reading, have missed something buried in the mass of words. However, it did not find any allegations to the effect that Deloitte intended its annual audits to reach and influence either a particular shareholder or creditor, known to it, or a group or class of shareholders or creditors, distinct from the much larger class who might reasonably be expected sooner or later to have access to the information and foreseeably to take some action in reliance upon those audits. [FN6] As stated in comment h to Sec. 552, "It is not enough that [Deloitte] merely knows of the ever-present possibility of repetition [of its audits] to anyone, and the possibility of action in reliance upon [them], on the part of anyone to whom [they] may be repeated."

> FN5. The party submitting the particular pleading, however, not the Court, must accept the consequences that flow from his chosen drafting style.
>
> FN6. In its review of the Third Amended Complaint for this purpose, the Court focused particularly on paragraphs 33-34, 50, 66-67, 69-70, 80, 88, 91, 101, 103 and 123 cited in that section of the Trustee's memorandum in opposition at p. 11, where he argues that his claims survive the *Nycal* test.

At this stage of the pleadings in this case--said to be the fifth proposed complaint--this failure is significant, and must be seen as more than just a scrivener's oversight. It seems quite appropriate for this Court to decline to infer that the necessary allegations relating to Deloitte's intent regarding the use of its audits can be made in a manner consistent with *Nycal* and compliant with the strictures of Mass.R.Civ.P. Rule 11. For these reasons, the First and Second Causes of Action by the shareholders and creditors should be

dismissed.

Chapter 93A.

The Third Cause of Action by the shareholders and creditors seeks relief for alleged violations of G.L.c. 93A. Deloitte attacks this cause of action for four separate reasons: (1) that this is a claim under Sec. 9 and there was no pre-suit demand letter; (2) that there was no commercial relationship between Deloitte and the shareholders or creditors; (3) that the acts did not occur primarily and substantially within the Commonwealth; and (4) that there are no allegations of individualized causation.

As to the issue relating to the demand letter--although the facts recited in Deloitte's memorandum at pp. 12-13 seem compelling--this is a hearing on a motion to dismiss, not on summary judgment. The Court is, therefore, confined to examining the Third Amended Complaint and not facts beyond its four corners. None of the procedural history recited in Deloitte's memorandum appears in the complaint. And neither side argues that there is a failure of pleading on this aspect of the c. 93A claim. In short, this ultimately may be a winning argument for Deloitte, but it is not on a Rule 12 motion.

In *Kuwaiti Danish Computer Co. v. Digital Equipment Corporation*, 438 Mass. 459 (2003), the SJC ruled that "a judge should, *after making findings of fact,* and after considering those findings, determine whether the center of gravity of the circumstances that give rise to the claim is primarily and substantially within the Commonwealth." (Emphasis added). *Id.* at 473. While this Court knows a lot about the *Kuwaiti Danish* case, it is not at all sure, but presumes from reading the SJC's opinion, that this particular ground for challenging a c. 93A claim--absent some extraordinary pleading concession by a claimant--cannot be resolved on a Rule 12 motion.

***8** On the issue of whether there was the necessary commercial relationship between Deloitte and the shareholders or creditors both sides cite to *Spencer v. Doyle*, 50 Mass.App.Ct. 6 (2000). In reaching its decision in *Spencer,* the Appeals Court explored the issue of whether a corporation, there called "BFG," contracted with C & L, the accounting firm of Coopers & Lybrand, in order to facilitate BFG's independent business goals or instead to facilitate investment in BFG's business. *Id.* at 10. Here, the equivalent of BFG is NutraMax and the equivalent of C & L is Deloitte.

In *Spencer,* after concluding that C & L was engaged as accountants to conduct an audit to prepare for a possible future public offering of BFG, the Appeals Court concluded that C & L was not engaged to create an audit to be used to solicit investments in BFG's ongoing business. The Appeals Court then held that "there was no commercial relationship between [the investors in BFG's ongoing business] which placed C & L and the plaintiffs in privity with one another." *Id.* at 12. Consequently, the c. 93A claim failed in *Spencer;* and for similar reasons it must fail here. Deloitte was engaged to do annual audits of the financial statements of NutraMax, not to help NutraMax solicit people to become shareholders or creditors. The relationship, if any, between Deloitte and the shareholders and creditors was at most a minor or insignificant business relationship. See, e.g., *Reisman v. KPMG Peat Marwick LLP*, 57 Mass.App.Ct. 100, 125a (2003); *Standard Register Co. v. Bolton-Emerson, Inc.*, 38 Mass.App.Ct. 545, 551 (1995).

Professional malpractice.

The fourth of the shareholders' and creditors' claims against Deloitte is for professional malpractice. The Trustee argues that, despite the fact that the shareholders and creditors were not clients of Deloitte, the professional malpractice claim should survive against them "[b]ecause the Complaint's allegations satisfy *Nycal.*" See Trustee's memorandum in opposition at p. 13. This Court, however, has already ruled that the First and Second Causes of Action of the Third Amended Complaint by the shareholders and the creditors does not satisfy *Nycal.* For that same reason, *Nycal* provides no basis to extend Deloitte's professional malpractice liability to them; indeed, it demonstrates just the opposite.

Claims Brought by NutraMax

The claims brought by NutraMax consist of three of the four claims brought by the shareholders and creditors: fraud; violation of G.L.c. 93A; and professional malpractice.

The Court begins with some general observations about the nature of a corporation, and through whom and how it acts.

A corporation

is a viable legal person separate and distinct from its shareholders, officers and employees, possessing virtually all of the legal attributes of a natural person. See *My Bread Baking Co. v. Cumberland Farms, Inc.*, 353 Mass. 614, 618-19 (1968). Most pertinently, it has the capacity to make ... contracts and to sue and be sued, see G.L.c. 156B, § 9(b), (h), and to be held both civilly and criminally responsible (including as an aider and abettor) for actionable wrongs committed by its responsible officers. See *Commonwealth v. Beneficial Fin. Co.*, 360 Mass. 188, 249-50, 253-55, 270-71, 276-81 (1971), cert. denied, 407 U.S. 914 (1972); *Kyte v. Philip Morris, Inc.*, 408 Mass. 162, 166-69 (1990); Model Penal Code and Commentaries § 2.07(1)(a), (1)(c), (4)(c) and comments (1980).

***9** *Beaupre v. Cliff Smith & Associates*, 50 Mass.App.Ct. 480, 494 (2000).

A corporation can only act through its officers and directors, and those others who are its agents.

A corporation is a separate and distinct legal entity. See *Spaneas v. Travelers Indem. Co.*, 423 Mass. 352, 354 (1996); *Gurry v. Cumberland Farms, Inc.*, 406 Mass. 615, 625-26 (1990). A corporation, however, can only act through its agents. See *Commonwealth v. L.A.L. Corp.*, 400 Mass. 737, 743 (1987), *Commonwealth v. Beneficial Fin. Co.*, 360 Mass. 188 (1971), cert. denied sub nom. *Farrell v. Massachusetts*, 407 U.S. 910, and sub nom. *Beneficial Fin. Co. v. Massachusetts*, 407 U.S. 914 (1972).

Under agency principles, notice to a corporation's agent is notice to the corporation. "When an agent acquires knowledge in the scope of [his] employment, the principal ... is held to have constructive knowledge of that information." *DeVaux v. American Home Assur. Co.*, 387 Mass. 814, 818 (1983), citing *Bockser v. Dorchester Mut. Fire Ins. Co.*, 327 Mass. 473, 477-78 (1951), and *Union Old Lowell Nat'l Bank v. Paine*, 318 Mass. 313, 323-24 (1945). *Juergens v. Venture Capital Corp.*, 1 Mass.App.Ct. 274, 278 (1973) (corporate officer's knowledge of transaction was constructive notice to corporation). However, an agent's knowledge of his own unauthorized acts is not imputed to the principal when the agent has acted fraudulently toward the principal and is engaged in an independent fraudulent act from which the principal does not benefit. *Tremont Trust Co. v. Noyes*, 246 Mass. 197, 207 (1923). See Restatement (Second) of Agency, § 282 (1958) ("[a] principal is not affected by the knowledge of an agent in a transaction in which the agent secretly is acting adversely to the principal and entirely for his own or another's purposes").

Sunrise Properties, Inc. v. Bacon, Wilson, Ratner, Cohen, Salvage, Fialky & Fitzgerald, P.C., 425 Mass. 63, 66-67 (1997).

However, when a senior officer of a corporation, like its president, who is clearly an agent of the corporation and "who was acting within the scope of his employment when he learned of circumstances that might give rise to a claim against both him and [the corporation] ... under ordinary agency principles, [his] knowledge is imputed to [the corporation]. *Id.* at 67.

"Ultra vires is not a defence to an action to recover damages against a corporation on account of the fraud of one of its officers acting within the scope of his authority, even if it was perpetrated in a transaction in which the corporation was not authorized to engage." *McCarthy v. Brockton National Bank*, 314 Mass. 318, 324-25 (1943).

"The general rule ... is that the knowledge of an officer of the corporation obtained while acting outside the scope of his official duties, in relation to a matter in which he acted for himself and not for the corporation, is not, merely because of his office, to be imputed to the corporation." *Phoenix Sav. & Loan, Inc. v. Aetna Cas. & Sur. Co.*, 427 F.2d 862 (4th Cir.1970), quoting *William Danzer & Co. v. Western Md. Ry.*, 164 Md. 448, 457, 165 A. 463 (1933). However, "knowledge of officers and directors having substantial control of all activities of a corporation is imputed to the corporation." *Phoenix Sav. & Loan, Inc. v. Aetna Cas. & Sur. Co.*, 381 F.2d 245, 250 (4th Cir.1967), remanded, 302 F.Sup. 832 (D.Md.1969), rev'd on other grounds, 427 F.2d 862 (4th Cir.1970). See Fletcher, *Cyclopedia of Corporations* § 826 (rev. ed.1994) (general rule of not imputing knowledge to corporation not applicable where "board of directors has ... complete control and direction of all of the business and affairs of

the institution, and the president has habitually exercised the same"). When "all corporate power is exercised by a few who perform misdeeds, knowledge of those misdeeds must be imputed to the corporation." *Phoenix Sav. & Loan, Inc. v. Aetna Cas. & Sur. Co.*, 302 F.Sup. 832, 840 (D.Md.1969). See *Jefferson Park Realty Corp. v. Ridgely*, 99 Ind.App. 146, 164 (1934), quoting Thompson, *Corporations* § 1777 (3d ed.1927) ("if [an agent] is the sole representative in the transaction, and is in effect the alter ego, notice to him is imputable to the [corporation]").

***10** *Demoulas v. Demoulas*, 428 Mass. 555, 584-85 (1998).

It is with this general background that the Court now considers the claims brought on behalf of NutraMax.

As noted in the Background section above, the third amended complaint contends that in 1995 three NutraMax officers--its President and CFO, its Vice President and CFO and its Controller--"falsified NutraMax's financial statements in many material respects." Third Amended Complaint, para. 2. The complaint does not allege that the Officers did so for their own personal purposes, however, but rather "in order to meet earnings expectations and fraudulently to maintain the Company's access to debt financing by falsifying base reports." See, e.g., Third Amended Complaint, para. 100. These are allegations of fact which are binding on the Trustee. G.L.c. 231, Sec. 87.

By the Massachusetts law rehearsed above, these allegations are also imputed to and binding upon NutraMax as knowledge of officers and directors having substantial control of the activities of the corporation.

The Third Amended Complaint, at para. 2, also alleges the binding facts that the improper activities of its Officers began in 1995. There are further factual allegations regarding things that occurred "at least as early as September 1996." See Third Amended Complaint, paras. 28-30. This case was transferred to this Court in February 2004, having apparently been first filed by the Trustee in the U.S. District Court in March 2001. These facts present statute of limitations issues.

Under Massachusetts law, the statute of limitations for fraud claims is three years after the plaintiff learns or reasonably should have learned of the alleged misrepresentations. G.L.c. 260, 2A; *Kent v. Dupree*, 13 Mass.App.Ct. 44, 47 (1982). A similar three-year statute of limitations applies to professional malpractice claims. G.L.c. 260, Sec. 4; *Frank Cooke, Inc. v. Hurwitz*, 10 Mass.App.Ct. 99, 109-11 (1980).

The statute of limitations for G.L.c. 93A claims is four years. G.L.c. 260, Sec. 5A; *Inter-national Mobiles Corp. v. Coroon & Black/Fairfield & Ellis, Inc.*, 29 Mass.App.Ct. 215, 220-21 (1990).

Given the knowledge of the Officers, imputed to NutraMax, there is nothing inherently unknowable about the alleged fraud, professional malpractice or c. 93A claims here. NutraMax certainly had reasonable "[c]ause to inquire about facts giving rise to [each of these] cause[s] of action." *Salinsky v. Perma-Home Corp.*, 15 Mass.App.Ct. 193, 197 n. 6 (1983). Consequently, the three-year statutes of limitations bar any claims by NutraMax for fraud or professional malpractice against Deloitte arising out of the 1995, 1996 and 1997 audits. The fraud and professional malpractice claims relating to the 1998 audit, however, are not barred for statute of limitations reasons. Similarly, the c. 93A claims relating to the 1995 and 1996 audits are barred by the limitation of actions provision, but the claims relating to the 1997 and 1998 audits are not.

***11** Deloitte next argues that whatever remains of the fraud and professional malpractice claims for the 1998 audit, and the c. 93A claims for the 1997 and 1998 audits, should be dismissed because there are not sufficient allegations by NutraMax of reliance or causation.

To this Court, the rub is that, despite NutraMax's imputed knowledge of what its Officers may have been doing, and its actual knowledge of what its Audit Committee had been told by Deloitte, Deloitte nevertheless provided unqualified audits for each of the four fiscal years from 1995 to 1998. Whether those unqualified audits for the 1997 and 1998 audit years not eliminated by the c. 93A limitations period, or the 1998 audit year not eliminated by the fraud and professional malpractice limitations periods, met the minimum standards applicable to Deloitte cannot be determined on the present Rule 12 motion. As independent

auditors, Deloitte should, at a minimum, have complied with generally accepted accounting standards in conducting its several audits. Can there be compliance and still provide an annual audit opinion that NutraMax's financial statements were free of material misstatements?

Whether such compliance was met, and what harm was caused by any failure--in the face of Deloitte's reporting "reportable conditions" involving "significant deficiencies," making recommendations for corrective action and continually seeing none, while still issuing unqualified audits thereafter--certainly is not beyond the allegations pled in the Third Amended Complaint or the reasonable inferences to be drawn therefrom.

ORDER

For the foregoing reasons, the Court makes the following rulings on Defendant Deloitte & Touche LLP's Motion to Dismiss the Third Amended Complaint (Paper # 52): (1) as to all claims by the shareholders and creditors, the motion is *ALLOWED;* and as to those claims by NutraMax Products, Inc. relating to audit years 1995, 1996 and 1997 for fraud and professional malpractice, and as to those claims by it for violations of G.L.c. 93A relating to audit years 1995 and 1996, the motion is *ALLOWED.* As to the fraud and professional malpractice claims of NutraMax Products, Inc. relating to audit year 1998, and as to the G.L.c. 93A claims of NutraMax Products, Inc. relating to audit years 1997 and 1998, the motion is *DENIED.*

Not Reported in N.E.2d, 18 Mass.L.Rptr. 287, 2004 WL 2341344 (Mass.Super.)

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