UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In re REFCO INC. SECURITIES LITIGATION	:	Case No. 07-md-1902 (JSR)

This Document Relates to:

KENNETH M. KRYS, et al.,	:	Case No. 08-cv-3065 (JSR)
	:	Case No. 08-cv-3086 (JSR)
Plaintiffs, :		
	:	REPORT AND
-against-	:	RECOMMENDATION
	:	OF THE SPECIAL MASTER
CHRISTOPHER SUGRUE, et al.,	:	ON MOTIONS TO DISMISS
	:	BROUGHT BY DEFENDANTS
Defendants.	:	PRICEWATERHOUSECOOPERS
	:	AND MARI FERRIS

Daniel J. Capra, Special Master

Defendant PricewaterhouseCoopers ("PwC") moves to dismiss six counts of the Plaintiffs' First Amended Complaint ("FAC")— the only counts directed against it. Defendant Mari Ferris is charged in five of those Counts and moves to dismiss them. The Counts allege accountant malpractice (Count VI), fraud/misrepresentation (Count (VIII), and aiding and abetting (Counts VII, XVII, XVIII and XIX). Ferris is not charged in Count XVIII.

The Special Master has previously issued more than a dozen R and R's in the Refco matter. Some of these R and R's will be referred to herein. Abbreviations used in the prior R and R's will be used herein. Familiarity with all of the R and R's — and with Judge Rakoff's orders reviewing them — is presumed.

The Plaintiffs' claims arise from losses allegedly suffered when assets were transferred from segregated accounts at Refco LLC to unprotected accounts at Refco Capital Markets, Ltd. ("RCM"). According to the FAC, this action is brought to recover (i) $263 million plus interest in damages suffered by the SPhinX family of hedge funds ("SPhinX"); (ii) the lost business enterprise value and deepening insolvency damages suffered by SPhinX's investment manager, PlusFunds Group, Inc., ("PlusFunds") and (iii) damages suffered by the Assignors, a group comprised of SPhinX investors. First Amended Complaint ¶1. The damages claims of the Assignors have, however, been dismissed

for lack of standing and will not be considered in this Report and Recommendation.

The gravamen of the complaint is that SPhinX's excess cash was diverted "from protected, customer segregated accounts to unprotected offshore accounts, where those assets were ultimately lost in the Refco scandal." Id.[1]

For the reasons stated below, the Special Master recommends that a) the claims in all Counts against Ferris be dismissed with prejudice; and b) the claims in all Counts against PwC be dismissed with prejudice, with the exception of Count XVII, where the motion to dismiss should be granted in part and denied in part. .

I. Allegations Forming the Basis of the Complaint Against These Defendants

The gravamen of the Plaintiffs' complaint is that SMFF excess cash in segregated accounts at Refco LLC were— without authorization — swept into commingled accounts at RCM and ultimately lost in the Refco scandal because they were not protected from RCM's insolvency. As pertinent to these motions to dismiss, the Plaintiffs' basic allegations are as follows:

- PwC was retained to serve as the outside auditor for various SPhinX entities (including SMFF), and PlusFunds, for the years 2003 through 2005. Ferris was the engagement partner on these audits. FAC ¶ 607. These audits were not conducted in accord with GAAS; if they had been the audit reports would either have revealed that SMFF cash was unprotected, or an audit report would not have been issued — in either case, innocent decisionmakers and SPhinX and PlusFundswould have taken the SMFF cash out of RCM. FAC ¶ 1149.

- PwC and Ferris aided and abetted breaches of fiduciary duty by Owens, Kavanagh, DPM, Aaron, et.al, by knowing about the transfers to unprotected accounts at RCM and yet issuing unqualified audit opinions and failing to disclose the risk. FAC ¶ 1166.

- The clean audit opinions issued for SMFF and PlusFunds contained affirmative misrepresentations that caused SPhinX and PlusFunds to allow the SPhinX cash to remain in unprotected RCM accounts, and also to continue to do business with DPM (an entity that was breaching its own fiduciary duties by not disclosing the fact that the SMFF cash was unprotected). FAC ¶ 1149.

- PwC was retained to prepare and approve Refco's financial statements and public filings in connection with the LBO and IPO and to provide other financial advisory services. FAC

[1] The facts pertinent to these motions have been recounted in a number of opinions by Judge Lynch (*see, e.g., Kirschner v. Grant Thornton*, 2009 WL 996417 (S.D.N.Y. 2009)) and in a number of R and R's by the Special Master. To the extent necessary for background on the instant motion, familiarity with the financial schemes of Refco is assumed.

¶¶ 570-74. In that capacity, PwC became aware of the Refco fraud and aided and abetted it by preparing statements that, among other things, did not disclose the RGHI receivable. FAC ¶ 1261. In addition, PwC and Ferris aided and abetted the Refco fraud by issuing clean audit opinions of SPhinX and PlusFunds, which failed to disclose the Refco fraud and failed to disclose the siphoning of SMFF cash out of the RCM accounts. FAC ¶ 1262.

- Because PwC knew about and assisted the Refco fraud due to its work for Refco, and also issued unqualified audit opinions for SPhinX and PlusFunds, PwC aided and abetted the breach of fiduciary duties owed by the Refco entities to SPhinX and PlusFunds (FAC ¶¶ 1276-77) and aided and abetted Refco's conversion of the SMFF cash. FAC ¶¶ 1287-88.

II. Standards for Reviewing the Plaintiff's Allegations on a Motion to Dismiss

"Federal Rule of Civil Procedure 8(a)(2) requires only 'a short and plain statement of the claim showing that the pleader is entitled to relief,' in order to 'give the defendant fair notice of what the claim is and the grounds upon which it rests.' " *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555, (2007) (quoting Fed.R.Civ.P. 8(a)(2)). "To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.' " *Ashcroft v. Iqbal*, 129 S.Ct. 1937, 1949 (2009) (quoting *Twombly*, 550 U.S. at 570). The requirement of "factual matter" means that "recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice." Id. at 1949. Rather, "[a] claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." Id. "Where a complaint pleads facts that are 'merely consistent with' a defendant's liability, it 'stops short of the line between possibility and plausibility of "entitlement to relief." ' " Id. (quoting *Twombly*, 550 U.S. at 557). If the factual allegations rise only to the level of the "mere possibility of misconduct," the complaint should be dismissed. *Starr v. Sony BMG Music Entn't*, 592 F.3d 314, 321 (2d Cir.2010).

For all counts sounding in fraud — in this case, Counts VII, VIII, XVII, and XVIII — the allegations must be evaluated more closely because Federal Rule of Civil Procedure 9(b) requires a plaintiff to plead fraud with particularity. Fed.R.Civ.P. 9(b). Under that rule, a plaintiff must "allege facts that give rise to a strong inference of fraudulent intent." *Acito v. IMCERA Group, Inc.*, 47 F.3d 47, 52 (2d Cir.1995). "The requisite 'strong inference' of fraud may be established either (a) by alleging facts to show that defendants had both motive and opportunity to commit fraud, or (b) by alleging facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness." *Shields v. Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1128 (2d Cir.1994). The Plaintiff must specifically describe the acts or statements alleged to be fraudulent and provide some factual basis that creates a plausible inference of fraudulent intent. Id. The particularity requirement applies not only to fraud claims but also to all claims sounding in fraud, including the claims for aiding and abetting fraud and aiding and abetting breaches of fiduciary duty in this case. *See, e.g., Henneberry v. Sumitomo Corp. of America*, 415 F.Supp.2d 423, 464 (S.D.N.Y. 2006) ("Rule 9(b)'s heightened pleading standards apply to breach of fiduciary claims where the breach is premised on the [underlying wrongdoer's] fraudulent conduct."). Claims sounding in conversion — in this case,

Count XIX — are evaluated under Rule 8, not Rule 9. *Kirchner v. Bennett*, 648 F. Supp. 2d 525, 542, n.3 (S.D.N.Y. 2009).

III. Review of Counts in the Complaint

A. Count VI: Accountant Malpractice (against both Defendants).

The Plaintiffs' basic premise for Count VI is that PwC and Ferris conducted an improper audit, thus failing to uncover the fact that the excess cash at RCM was completely unprotected, and issuing clean audit opinions for SPhinX and PlusFunds for the years 2003 and 2004. FAC ¶ 1149. The Plaintiffs further state that innocents at SphinX and PlusFunds — who did not know that the funds were unprotected — relied on these clean audit opinions, and if PwC and Ferris would have disclosed the lack of protection these innocents would have acted to take the money out of RCM. Id.

To be specific, the alleged wrong is *not* that the Defendants failed to disclose that the SMFF cash was at RCM or transferred from Refco LLC to RCM. The Plaintiffs state in their Complaint that innocents at PlusFunds were aware that the excess cash was transferred to RCM — but they were not aware that RCM was an unregulated entity and that the cash was unprotected there. FAC ¶ 183. See also Owens and Kavanagh R and R at 18 (concealment claim based not on transfers of cash but on failing to disclose that it was unprotected while at RCM).

To prevail on this claim, the Plaintiffs must show that the defendants, in the course of an audit properly done under GAAS and GAAP would have discovered not only *where* the assets were but also that the assets were completely unprotected from RCM's insolvency while there. The Plaintiffs spend many pages of the Amended Complaint alleging the defendants' alleged failures in conducting the audit — including not being sufficiently independent; non-compliance with the rules of the Irish Stock Exchange; and lack of heightened skepticism after identifying weaknesses in internal controls. But these allegations are all red herrings because even if they were true, none of those flaws if corrected would having anything to do with discovering that the cash at RCM was unprotected from the risk of an RCM bankruptcy. This is because the auditors' duty, pursuant to the engagement letters, was to audit SMFF's cash balances. The parties are in basic agreement with the Plaintiffs' assertion in FAC ¶ 702:

> PwC simply requested from Refco confirmation letters confirming the amount of cash being held at Refco. PwC did nothing to confirm that those assets were safeguarded, including

> being segregated and protected from the claims of Refco's and RCM's creditors as required by law and as represented in the footnotes to SPhinX's financial statements and in SPhinX Funds/PlusFunds' promotional materials.

The nub of the disagreement here is whether the auditors had a duty not only to confirm the location, existence, and amount of the cash balances, but also to investigate whether the cash was *safe* where it was. Nothing in the hefty allegations indicates that the Defendants agreed to undertake, or had a duty to undertake, the latter obligation. Both the engagement letters and PwC's audit opinions state that the scope of the auditor's duty was limited to "examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements." *See, e.g.,* 2004 SPhinX engagement letter, Ex. 2 to Capra Declaration; SMFF 2004 Financial Statements, Ex. 15 to Capra Declaration.[2] Similarly the GAAS standards on which the Plaintiffs so heavily rely do not state that once an auditor verifies the existence and location of assets, the auditor must further investigate how those assets are treated by the third party holding them. See AU § 150.02, set forth at FAC ¶ 624.

Indeed several courts have recently categorically rejected the notion that an accountant is required to act as an investment advisor or legal compliance officer by investigating the status of assets at a third party. Judge Griesa probably put it best in *In re Tremont Securities Law, State Law and Insurance Litig.*, 703 F.Supp.2d 362 (S.D.N.Y.2010), a lawsuit against the auditors of feeder funds that funneled money to Bernard Madoff's Ponzi scheme. The auditors verified the accuracy of the feeder funds' financial statements but did not inquire into, and did not make any statement about, Madoff's improper use of the funds. The plaintiffs argued that if the auditors had followed GAAS, they would have discovered that Madoff (through BMIS) was misusing the assets. Judge Griesa categorically rejected that contention:

> But most critically, the Auditors were never engaged to audit Madoff's businesses or to issue an opinion on the financial statements of BMIS. The Auditors' only role is that they audited the financial statements of the Rye Funds and the Market Neutral Fund. *The notion that a firm hired to audit the financial statements of one client (the Rye Funds and the Market Neutral Fund) must conduct audit procedures on a third party that is not an audit client (BMIS) on whose financial statements the audit firm expresses no opinion has no basis.* To impose liability on the Auditors would expand their limited, circumscribed duty impermissibly.

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[2] Both the engagement letters and the financial statements are heavily referenced in the FAC and so may be considered on this motion to dismiss. *Global Network Commc'ns, Inc. v. City of New York,* 458 F.3d 150, 157 (2d Cir. 2006) (a court may rely on material extraneous to the complaint if it is integral to the complaint and relied on by the plaintiff in drafting the complaint).

Id. at 371 (emphasis supplied).[3]

The Plaintiffs seek to make much of the fact that the Defendants were aware, from the financial statements and other documentation, that the SMFF cash was represented as being segregated and that segregation requirements were critical to the PlusFunds/SPhinX business plan — and also that they knew about the CFTC segregation requirements.[4] But all that information says nothing about whether the auditors *had a duty to confirm that the assets were segregated when at RCM*. The fact that an auditor is aware of a business plan does not mean that the auditor in opining on financial statements has a duty to make sure the plan is working. Nothing in the engagement letters or GAAS imposes such a requirement.

The Plaintiffs rely heavily on the assertion that Ferris (and therefore presumably PwC) actually *knew* that the excess cash at RCM was unprotected, and yet issued clean audit opinions. See, e.g., FAC ¶¶ 622, 641. This assertion of actual knowledge is based solely on a statement made by Ferris at the end of her seven-plus hour deposition. The exchange was as follows:[5]

> Q. Were you aware [that the SPhinX cash] was at risk of being lost in the event of the failure of Refco?
>
> Mr. Capra: Objection to the form.

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[3] Other courts in similar cases involving the Madoff matter have similarly stated that the accountants of the feeder funds had no duty to determine whether the assets in the hands of the third party BMIS were being misused. *See, e.g., Anwar v. Fairfield Greenwich Ltd.* 728 F.Supp.2d 372, 453, n.23 (S.D.N.Y.2010) (accountant has no duty to investigate red flags at a third party non-client, as opposed to the audit client itself); *Stephenson v. PricewaterhouseCooper, LLP,* 768 F.Supp.2d 562, 580-81 (S.D.N.Y. 2011)(dismissing complaint against auditor of feeder funds: "In the end, the nub of Stephenson's complaint is that PWC failed to uncover and report fraud at BMIS—a firm it was never hired to audit."); *Meridian Horizon Fund, LP v. Tremont Group Holdings, Inc.*, 747 F.Supp.2d 406, 413 (S.D.N.Y.2010).

[4] Section 4d of the Commodities Exchange Act prohibits the commingling of customer funds with the funds of a future commissions merchant — like Refco LLC. 7 U.S.C. § 6(d)(a)(1). The CFTC regulations implementing the Commodities Exchange Act contain among other things strict segregation requirements for customer funds (17 C.F.R. § 1.20) and provide that customer funds may not be invested "in obligations of an entity affiliated with the futures commission merchant." 17 C.F.R. § 1.25(b)(6).

[5] The Plaintiffs rely on Ferris's deposition testimony at several points in the FAC, and therefore it can be considered on a motion to dismiss. *Brass v. Am. Film Techs., Inc.*, 987 F.2d 142, 150 (2d Cir. 1993) (documents incorporated by reference in the complaint may be considered on a motion to dismiss).

Ferris: All amounts with counterparties are subject to credit risk, financial statements are — financial statements include amounts that are subject to credit risk and those amounts include those amounts that were — those amounts were subject to credit risk, I was aware of that, yes.

Q: You were aware prior to the conversation with Mr. Butt that the hundreds of million dollars in cash at Refco were subject to credit risk?

Ferris: Yes, I was.

Mr. Capra: We are a little bit beyond our seven hours.

But Ferris's testimony does not assist the Plaintiffs' allegations that the Defendants were aware that the cash at RCM was completely unprotected. This is so for a number of reasons. First, the Plaintiffs' own Complaint renders it implausible to conclude that Ferris knew that the transfer of SMFF excess cash from Refco LLC to RCM had caused those assets to lose the protections they enjoyed at Refco LLC. FAC ¶ 702 complains that "Ferris indicated, and PwC's audit working papers confirm, that PwC simply requested from Refco confirmation letters confirming the amount of cash being held at Refco. PwC did nothing to confirm that those assets were safeguarded." So if PwC did nothing to confirm whether the assets were protected, how would Ferris know they were unprotected? The Plaintiffs cannot have it both ways. Plaintiffs' counsel at oral argument, in response to the Special Master's question of how Ferris could know about the assets being unprotected when the FAC says she never looked, stated "How she knew? I don't know how she knew, but she says she knew, so." Transcript at 292. But the implausibility of the Plaintiffs' scenario — that Ferris somehow knew and we have no idea how — much more likely indicates that her deposition testimony was *not* in fact an admission that she knew the assets were completely unprotected at RCM.

Second, a fair reading of the transcript indicates that Ferris was not talking about the complete loss of protection that occurred when the assets were transferred to RCM. Her extended answer to counsel's first volley was generic — there is risk in every transaction with a counterparty. Indeed the Plaintiffs themselves concede such a risk — one that the Plaintiffs have called an "open jaw" risk. See Transcript of Oral Argument in Krys v. Aaron at 96 (Plaintiffs' counsel noting that "when you execute a transaction it's not closed for a period of time, and while it's not closed, if there's insolvency you're exposed to that risk . . . because it leaves the segregated account for the time that it takes to open until it takes to close."). Ferris's generic statement about risk for *any* amount held by *any* counterparty *anywhere* can hardly be interpreted as knowledge that the SMFF excess cash lost all protection when it was transferred to RCM. The only plausible conclusion to that answer is that she was talking about the generic, "open jaw" risk.

The Plaintiffs argue that Ferris's answer to the last question asked at her deposition must be a concession about the SMMF assets' complete loss of protection because she was asked about "hundreds of millions of dollars of credit risk" and the open jaw risk would be significantly less than

that. That argument is weak, however, given the context of the compound question and the three word answer. There is no indication that, at the end of a seven-hour deposition, Ferris was making a complete shift from her original, generic point about the risk in every counterparty transaction to an opinion about the specific loss of protection occurring after transfer of the cash from Refco LLC to RCM.

In essence, the Plaintiffs' attempt to make so much of Ferris's generic answers at the end of a long deposition is a classic form of "gotcha." The Plaintiffs have mischaracterized Ferris's deposition testimony, leaving them with no supported assertions that PwC or Ferris actually knew that the cash lost *all* protection when it was transferred to RCM.

The Plaintiffs' other argument on Ferris's scienter is that she was engagement partner for auditing the financial statements of certain Refco portfolio funds, and thereby was in "a unique position to gain knowledge of Refco's business operations and structure." FAC ¶ 569. But this is a conclusory allegation, providing no indication of how working on a portfolio fund would provide any knowledge whatsoever about the specific fact that assets of SMFF were completely unprotected at RCM.

The Plaintiffs' final argument is that PwC, in rendering its advisory services for Refco in the LBO and IPO became aware of the Refco fraud and knew that RCM assets were being diverted. FAC ¶ 1150. The Complaint is unclear on the point, but seems to imply that because one PwC team was working on Refco, it had a duty to share its information with Ferris's team that was doing the audits of SPhinX and PlusFunds. There is no allegation that the Refco-related information (whatever it was), was actually shared with the SPhinX/PlusFunds auditing team, and nothing in Ferris's deposition testimony indicates that she was informed about anything involving the advisory services that PwC performed for Refco. So the Plaintiff's allegation is not that the information was actually provided but that it should have been — or that it should be deemed to have been because PwC as a firm is responsible collectively for what its employees know.

The first problem with the Plaintiffs' attempt to connect the Refco work with the malpractice Count is that it has absolutely no relevance to the cause of action against Ferris personally. *Assuming* that the PwC team on Refco had some duty to provide information to the team on SPhinX/PlusFunds, surely Ferris cannot be responsible for its failure to do so, as she was not on the Refco team. Moreover, the concept of collective knowledge cannot be applied against individual employees. Thus, the Plaintiffs' allegations regarding Refco do nothing to remedy their failure to adequately allege that Ferris knew or should have known that the cash at RCM was completely unprotected.

The second problem with the Plaintiffs' attempt to link the Refco work to malpractice is that there is no allegation that the Refco team became aware that the cash at RCM was unprotected. FAC ¶ 1150 states that "[i]n its relationship with Refco, PwC became aware of the Refco fraud and knew that RCM customer assets (including SMFF's cash) were being diverted to fund Refco's business and conceal Refco's losses and true financial condition." Even if PWC on the SPhinX/PlusFunds side were made aware of this information, that would not have changed anything about the audit.

The Plaintiffs concede that the audit letters accurately reported the amount of cash at RCM. Their argument regarding the audit letters is not that PwC failed to report about transfers out of RCM, but rather that PwC failed to report that the assets that were *at* RCM were unprotected. Finally, the Plaintiffs have throughout this litigation argued that the Refco fraud was a separate injury, and would have had little effect on them if the cash at RCM had been segregated. *See, e.g.*, Standing R and R at 7. That is, the upstreaming from RCM is a wrong that is separate from the transfer to RCM that resulted in the loss of segregation. Thus, nothing about the PwC advisory work for Refco adds to the allegations on accountant malpractice.

Finally, and most importantly, the Plaintiffs have not established that PwC actually *had* an obligation, arising out of its Refco work, to inform its team working on SPhinX/PlusFunds about anything regarding Refco. The Plaintiffs claim that PwC is responsible for the collective knowledge it obtained while working at Refco and SPhinX/Plus Funds. It relies on *In re Worldcom, Inc., Sec. Litig.*, 352 F.Supp.2d 472, 499-500 (S.D.N.Y. 2005), in which the court stated that a Lead Plaintiff was "entitled to show that Anderson as a firm was reckless with respect to its certification of WorldCom's financial statements through the sum of its employees' activities and knowledge."

But *WorldCom* is eminently distinguishable, as Judge Holwell recently noted in *Stephenson v. PricewaterhouseCoopers, LLP*, 768 F.Supp.2d 562, 575 (S.D.N.Y. 2011). In rejecting the very "collective knowledge" argument that the Plaintiffs make in this case, Judge Holwell declared that there was no support for the proposition "that one member of a global firm can be charged with actual knowledge of all information in the global firm's database." He noted that *Worldcom* was not to the contrary, because that case involved a situation in which the auditor "had unlimited access to WorldCom's books and records and had, as WorldCom's independent auditor, an obligation to review and evaluate those records in order to form an opinion regarding WorldCom's financial statements." Id. at 576, n.4. Judge Holwell also noted that *Worldcom* involved a duty owed to, and information about, a single entity being audited, and so was readily distinguishable from a case in which the information concerned a corporation different from the one being audited. Thus, the Plaintiffs' attempt to make something out of PwC's advisory work for Refco — as applied to the fact that SMFF cash at RCM was unprotected — misses the mark.

In sum, the Plaintiffs have not adequately alleged a cause of action for accountant malpractice, because nothing in the FAC establishes that PwC was required to determine the status of the SMFF cash at RCM (as opposed to its existence and amount), and no plausible inference can be drawn that PwC or Ferris knew about or recklessly disregarded the complete lack of protection. The Plaintiffs' Count VI should therefore be dismissed in its entirety. And that dismissal should be with prejudice, because not only have the Plaintiffs already had an opportunity to amend, but more importantly any amendment would be futile because there is nothing in the engagement letters or in GAAS to indicate that the defendants had any duty to investigate whether the cash at RCM was completely unprotected, and nothing further to indicate actual knowledge. Nothing that the Plaintiffs could add to a complaint would fix those deficiencies in their pleading. *See McCarthy v. Dun & Bradstreet Corp.*, 482 F.3d 184, 200 (2d Cir.2007) ("A district court has discretion to deny leave for good reason, including futility, bad faith, undue delay, or undue prejudice to the opposing party.").

Recommendation on Count VI: Count VI should be dismissed in its entirety with prejudice.

B. Count VIII: Fraud and Misrepresentation (Against Both Defendants)[6]

Like the malpractice count, the fraud count is all about the clean audit opinions for SPhinX and PlusFunds issued by PwC. The Plaintiffs argue that the clean audit opinions were fraudulent for the same reason that they were the product of malpractice: because they represented that they fairly presented the financial position of SPhinX and PlusFunds, when that was not the case in that they did not disclose that the SMFF excess cash was completely unprotected at RCM.[7]

To prove fraudulent misrepresentation under New York law, a plaintiff must show that: (1) the defendant made a material false statement, (2) the defendant intended to defraud the defendant thereby, (3) the plaintiff reasonably relied upon the representation, and (4) the plaintiff suffered damage as a result of such reliance. *Blank v. Baronowski*, 959 F.Supp.172, 177 (S.D.N.Y.1997). The knowledge component of fraudulent misrepresentation can be satisfied by a showing that the defendant either knew the statements were false or had a "wilful, deliberate or reckless disregard for the truth that is the equivalent of knowledge." *Zucker v. Sasaki*, 963 F.Supp. 301, 305 (S.D.N.Y. 1997). Recklessness can be shown by a "refusal to see the obvious, or a failure to investigate the doubtful, if sufficiently gross." *Curiale v. Peat, Marwick, Mitchell & Co.*, 214 A.D.2d 16, 630 N.Y.S.2d 996, 1003 (1st Dept. 1995).

"The standard for pleading auditor scienter is demanding." *In re IMAX Sec. Litig.*, 587 F.Supp.2d 471, 483 (S.D.N.Y.2008). The Plaintiffs must adequately allege that "[t]he accounting practices were so deficient that the audit amounted to no audit at all, or an egregious refusal to see the obvious, or to investigate the doubtful, or that the accounting judgments which were made were such that no reasonable accountant would have made the same decisions if confronted with the same facts." *S.E.C. v. Price Waterhouse*, 797 F.Supp. 1217, 1240 (S.D.N.Y.1992). As Judge Lynch has noted, the scienter standard requires more than "a failure to follow GAAP." *In re Refco, Inc. Sec.*

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[6] Count VII is taken out of order because it makes more sense to group the three aiding and abetting counts together as they present many of the same issues — just as it makes more sense to group the malpractice and fraud claims together, for reasons expressed in text.

[7] The Plaintiffs also argue that the audit opinions were fraudulent because they averred that PwC was independent when in fact that was not the case. But clearly lack of independence would have been irrelevant to the innocents at PlusFunds if the audits disclosed the status of the cash at RCM. In other words, the claim is all about the failure to disclose the status of the cash and all the other allegations are either red herrings or part of the broader argument that the status of the cash should have been disclosed

Litig., 503 F.Supp.2d 611, 658 (S.D.N.Y.2007). *See also Anwar v. Fairfield Greenwich Ltd.*, 728 F.Supp.2d 372, 450 (S.D.N.Y.2010) ("Violations of professional auditing standards, without more, do not constitute strong circumstantial evidence of conscious recklessness."). Moreover, "[i]n the accounting context, failure to identify problems with the defendant company's internal controls and accounting practices does not constitute recklessness." *Stephenson v. PricewaterhouseCoopers, LLP*, 768 F.Supp.2d 562, 572 (S.D.N.Y. 2011) (citations and internal quotes omitted). "To rise to the state of mind required, these allegations must be coupled with evidence of corresponding fraudulent intent."Id. at 572-73 (citations and internal quotes omitted). The Plaintiffs must allege facts that give rise to "a strong inference of fraudulent intent, which may be established either (a) by alleging facts to show that defendants had both motive and opportunity to commit fraud, or (b) by alleging facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness."*Eternity Global Master Fund Ltd. v. Morgan Guar. Trust Co. of N.Y.*, 375 F.3d 168, 187 (2d Cir. 2004)(internal citations omitted)

The discussion of Count VI indicated that the Plaintiffs failed to plausibly allege either 1) that the defendants had a duty to determine whether the assets at RCM were completely unprotected, or 2) that the Defendants in fact knew that the assets at RCM were completely unprotected. It clearly follows that two elements of a fraudulent misrepresentation claim are missing here. First, there is no showing that the clean audit reports were materially misleading, because they did not misstate or fail to disclose anything that they were required to disclose. Second, there is a fortiori no showing of scienter under the strict standards applicable to auditors. Specifically, the Plaintiffs' allegations that the defendants failed to comply with GAAS are not nearly enough, under the case law above, to show scienter. Moreover, while the Plaintiffs allege that PwC was not independent when conducting its audits (FAC ¶ 1182), it is well-established that "an auditor's violation of an ethical duty of independence by itself does not give rise to a strong inference of fraud." *In re Parmalat Sec. Litig.*, 501 F.Supp.2d 560, 583 (S.D.N.Y.2007). Nor is PwC's expectation of receiving fees a sufficient motive to raise a strong inference of culpable intent. *See, e.g., In re Oxford Health Plans, Inc. Sec. Litig.*, 51 F.Supp.2d 290, 294 (S.D.N.Y.1999) ("generalized economic interests" such as "receipt of compensation and the maintenance of a profitable professional business relationship" does not give rise to strong inference of scienter (citing cases)).[8] Finally, the Plaintiffs' attempt to tie PwC's Refco advisory work to knowledge about the absence of protection for the SPhinX cash is, for the reasons discussed under Count VI, unavailing.

In sum, the Plaintiffs have failed to sufficiently allege a material misstatement and have not come close to sufficiently alleging scienter under the strict standards set forth above. Accordingly, Count VIII should be dismissed. And as with Count VI, the dismissal should be with prejudice as the Plaintiffs have already had the opportunity to amend, and it is apparent that repleading would

[8] *See also In re Stone & Webster, Inc., Sec. Litig.*, 414 F.3d 187, 215 (1st Cir. 2005) ("[A]bsent truly extraordinary circumstances, an auditor's motivation to continue a profitable business relationship is not sufficient by itself to support a strong inference of scienter.").

be futile at any rate.[9]

Recommendation on Count VIII: Count VIII should be dismissed in its entirety with prejudice.

C. Count VII: Aiding and Abetting Breach of Fiduciary Duty (Against both Defendants)

The Plaintiffs allege that the Defendants aided and abetted breaches of duty by a number of fiduciaries. The alleged aiding and abetting is the issuance of the clean audit opinions of SPhinX and PlusFunds. In order to state a cause of action for aiding and abetting a breach of fiduciary duty under New York law, a plaintiff must adequately plead "(1) the existence of a violation by the primary wrongdoer; (2) knowledge of the violation by the aider and abettor; and (3) proof that the aider and abettor substantially assisted the primary wrongdoer." *Chemtex, LLC v. St. Anthony Enterprises, Inc.*, 490 F.Supp.2d 536, 546 (S.D.N.Y. 2007). The plaintiff must "allege some facts, in non-conclusory terms, to show knowing participation by defendants in the alleged breach." *Musalli Factory For Gold & Jewelry v. JPMorgan Chase Bank, N.A.*, 261 F.R.D. 13, 24 (S.D.N.Y.2009) (internal quotations omitted). This section will review the Plaintiffs' allegations regarding each of the three elements for an aiding and abetting claim.

1. Primary Wrong – Breach of Fiduciary Duty.

Of course for the aiding and abetting claim to survive a motion to dismiss, the Plaintiffs must adequately allege the underlying breach of fiduciary duty. The underlying breaches alleged in Count VII are:

- PlusFunds' breach of duty owed to SPhinX. FAC ¶ 1154.
- Sugrue, Kavanagh and Owens's breach of duty owed to SPhinX. FAC ¶ 1155.
- Sugrue, Kavanagh and Owens's breach of duty owed to PlusFunds. FAC ¶ 1157.
- Refco LLC's breach of duty owed to SPhinX and PlusFunds. FAC ¶ 1158.
- RCM's breach of duty owed to SPhinX and PlusFunds. FAC ¶ 1159.
- DPM's duty owed to SPhinX "and/or" PlusFunds. FAC ¶ 1160.
- Aaron's duty owed to SPhinX "and/or PlusFunds. FAC ¶ 1161.

[9] For purposes of completeness, the Special Master notes that the Plaintiffs have established the other elements of a cause of action for fraud — reasonable reliance and damages. Specifically, if the unprotected status of the cash at RCM was within the scope of the audit and the Plaintiffs have sufficiently alleged scienter, it is plausible to assume that innocents at PlusFunds and SPhinX would have relied on the clean audit opinions for comfort that the assets remained protected — and would have tried to get the assets out of Refco if they had been told the contrary. See the Primary Wrongs R and R at 23.

Most of these alleged primary wrongs have already been the subject of three separate R and R's by the Special Master:

1) The Primary Wrongs R and R, dated March 1, 2010, and affirmed by Judge Rakoff, found that the Plaintiffs have sufficiently alleged a breach of duty by Refco: a) with regard to the SPhinX fraud, and b) with regard to the upstreaming the RCM assets portion of the Refco fraud. These are the very duties that the Plaintiffs alleged were breached by Refco in Count VII. See FAC ¶ 1163. Therefore the Plaintiffs have adequately alleged a breach of fiduciary duty by Refco LLC and RCM. See also Krys v. Aaron R and R at 33.

2) The Krys v. Aaron R and R, dated July 19, 2010, and affirmed by Judge Rakoff, found that the Plaintiffs have adequately alleged that a) DPM breached fiduciary duties owed to SPhinX and Plus Funds, and b) Aaron breached a fiduciary duty owed to SPhinX. But it also held that Aaron owed no fiduciary duty to PlusFunds. Accordingly, the claim in Count VII for aiding and abetting Aaron's breach of duty owed to PlusFunds must be dismissed with prejudice for failure to state a primary violation.

3) The Owens and Kavanagh R and R, dated October 21, 2010 — which has not yet been ruled on by Judge Rakoff — held the following: a) the Plaintiffs did not sufficiently allege that PlusFunds owed or breached a fiduciary duty to SPhinX; b) the Plaintiffs did not sufficiently allege that Kavanagh owed a fiduciary duty to SPhinX; and c) the Plaintiffs did not sufficiently allege that Owens or Kavanagh had breached fiduciary duties by actions to implement or allow the transfer of SMFF funds to RCM. However, the Plaintiffs had sufficiently alleged that Owens breached fiduciary duties owed to PlusFunds and SPhinX, and that Kavanagh had breached fiduciary duties owed to PlusFunds, by actions undertaken to maintain Refco's control over SMFF's excess cash — including concealing the improper transfers to unprotected accounts at RCM.

The result from the Owens and Kavanagh R and R is that a) the Plaintiffs' claim that PwC and Ferris aided and abetted a breach of fiduciary duty owed by PlusFunds to SPhinX must be dismissed with prejudice for failure to state a primary wrong; b) the Plaintiffs' claim that PwC and Ferris aided and abetted a breach of fiduciary duty owed by Kavanagh to SPhinX must be dismissed with prejudice for failure to state a primary wrong; and c) the Plaintiffs have adequately alleged the primary wrong of breach of fiduciary duty owed by Owens to SPhinX and PlusFunds and by Kavanagh to PlusFunds.[10]

That leaves the primary wrongs alleged by Sugrue. Sugrue of course has not responded to the Complaint against him, so there has been no finding regarding his alleged breach of fiduciary duties. But the Special Master has little difficulty in finding that the Plaintiffs have sufficiently alleged that Sugrue breached fiduciary duties owed to SPhinX and PlusFunds by taking a leading role in the unauthorized transfers of excess cash to unprotected accounts at RCM. Indeed the basis

[10] Of course any recommendation taken from the Owens and Kavanagh R and R will need to be adjusted if Judge Rakoff rejects it in his review of that R and R.

for finding a breach of fiduciary duty by Owens and Kavanagh was their close relationship with Sugrue. See Owens and Kavanagh R and R at 17-18.

Accordingly, the Plaintiffs have adequately alleged the following breaches of fiduciary duty as part of their aiding and abetting claims against PwC and PlusFunds:

- Sugrue and Owens's breach of duty owed to SPhinX.
- Sugrue, Kavanagh and Owens's breach of duty owed to PlusFunds.
- Refco LLC's breach of duty owed to SPhinX and PlusFunds.
- RCM's breach of duty owed to SPhinX and PlusFunds.
- DPM's duty owed to SPhinX and PlusFunds.
- Aaron's duty owed to SPhinX.

2. Knowledge:

To be liable on an aiding and abetting claim, the defendant must have had knowledge of the underlying wrongful conduct — a standard that is not satisfied by a mere allegation of constructive knowledge. *See Kolbeck v. LIT Am., Inc.*, 939 F. Supp. 240, 246 (S.D.N.Y. 1996) ("New York common law . . . has not adopted a constructive knowledge standard for imposing aiding and abetting liability"). To plead a cause of action for aiding and abetting breach of fiduciary duty, the plaintiff must allege both that "the defendant had actual knowledge of the primary violator's status as a fiduciary and actual knowledge that the primary violator's conduct contravened a fiduciary duty." Id. at 246-247. New York law requires that a plaintiff must allege facts that give rise to a "'strong inference'" of such knowledge. *Fraternity Fund Ltd. v. Beacon Hill Asset Mgmt., LLC*, 479 F. Supp. 2d 349, 367 (S.D.N.Y. 2007) (quoting *Lerner v. Fleet Bank, N.A.*, 459 F.3d 273, 293 (2d Cir. 2006)).

As stated in previous Reports and Recommendations, there is dispute in the case law on whether "conscious avoidance" is sufficient for the knowledge prong of an aiding and abetting claim. *Compare Fraternity Fund Ltd.*, 479 F. Supp. 2d at 368 (finding it sufficient to plead with particularity conscious avoidance — meaning that it can almost be said that, given the underlying circumstances, the defendant actually knew of the breach), *with Pension Committee of University of Montreal Pension Plan v. Banc of America Securities, LLC*, 446 F.Supp.2d 163, 202, n. 273 (S.D.N.Y.) (noting that the weight of authority under New York law requires actual knowledge, as distinct from "willful blindness"). The difference, however, between actual knowledge and "it can almost be said that the defendant actually knew" is, to say the least, a narrow one. And any difference is not material in this case.

In this case, the Plaintiffs allege that by going through the process of auditing SPhinX and PlusFunds, PwC and Ferris became aware of the fact that "the movement of SMFF's cash to RCM constituted a breach of the fiduciary duties owed" by the alleged primary wrongdoers. FAC ¶ 1175. The analysis of scienter in the discussions of Counts VI and VIII, supra, mandates a conclusion that the Plaintiffs have failed to allege knowledge sufficient to support aiding and abetting where the

basis for the alleged knowledge is the conduct of the audits. As stated above, nothing in the engagement letters or in the AICPA standards required the auditors to determine whether the cash had lost its protection when it was transferred to RCM — and the Plaintiffs actually plead that the auditors did not check that fact. If they did not check that fact, they could not have known that the transfers were improper; and "should have known" is clearly not enough. Again, the auditors knew that the transfers had been made and in fact reported the amount of cash at RCM — but it is "the *manner* in which the cash was held"[11] that was the actual wrong and the cause of the Plaintiffs' damages. And it goes without saying that if the Defendants didn't know that the cash was completely unprotected, they couldn't know that the transfers were a breach of fiduciary duty by any of the violators. To know that the transfers were a breach of fiduciary duty, the Defendants would have had to know that the transfers were unauthorized — and there is nothing alleged in the auditing process that would give rise to such knowledge. [12]

In this Count, the Plaintiffs do not allege that PwC's advisory work for Refco provided a basis for knowledge of wrongdoing. The only knowledge alleged is that "gained by PwC and Ferris as the auditor of SPhinX and PlusFunds." FAC ¶ 1175. But even if the Refco advisory work were included, it would not help to establish that PwC and Ferris knew that the cash was transferred without authorization into unprotected accounts. As discussed in detail above, a) any knowledge obtained through the Refco advisory work cannot be held against Ferris; b) there is no allegation that the Refco advisory work uncovered the fact that the cash was completely unprotected at RCM; and c) there is no authority for the proposition that an auditing firm working for two separate companies on two separate projects has a duty to pool its information or is subject to a collective knowledge

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[11] Plaintiffs' Opposition Brief at 10.

[12] The aiding and abetting Count thus fails for the same reason that a similar claim against Richard Butt failed. See the Butt R and R, dated August 4, 2010 at 12 (affirmed by Judge Rakoff):

> Ultimately, the Plaintiffs have not made the case that Butt knew, or consciously avoided, the fact that the transfers were unauthorized. This case is similar to *Design Strategy, Inc. v. Davis*, 469 F.3d 284, 303 (2d Cir. 2006), in which the plaintiff complained that defendants obtained business opportunities from a person who was, at the time, violating his duty of loyalty to the plaintiff-competitor. The court found that there could be no aiding and abetting where the defendants did not know that the person with whom they were dealing was acting without authorization and violating his duty of loyalty to his employer. The court noted that the defendants were "not under any independent affirmative duty to call Design to verify what Davis had represented." Similarly in this case there is nothing that required Butt to put everything together and determine that the transfers were unauthorized.

requirement.[13]

3. Substantial Assistance:

"In the aiding and abetting context, a plaintiff must allege that the defendant's substantial assistance in the primary violation proximately caused the harm on which the primary liability is predicated. The Plaintiffs must allege more than but-for causation. They must allege also that their injury was a direct or reasonably foreseeable result of the conduct." *Fraternity Fund Ltd. v. Beacon Hill Asset Management, LLC*, 479 F.Supp.2d 349, 370-71 (S.D.N.Y. 2007).[14]

Assuming arguendo that the Plaintiffs have shown that PwC had knowledge of those breaches of fiduciary duty that the Plaintiffs have adequately alleged, the Special Master finds that the Plaintiffs have adequately alleged that the Defendants substantially assisted those wrongs. *If* the auditors had a duty to report that the cash was unprotected — or even if they had no such duty and yet knew such a material fact — then disclosing that fact could plausibly have spurred the innocents at PlusFunds and SPhinX to act to protect the excess cash by taking it out of RCM. The Plaintiffs have more than adequately alleged that segregation was critically important to the SPhinX/PlusFunds business plan, and so any deviation from that plan as to hundreds of millions of dollars is certainly something that would have plausibly led the innocents to act. Moreover, the Plaintiffs have adequately alleged that the innocents at PlusFund and SPhinX would have relied on the auditors in determining whether to act. And as found in the Owens and Kavanagh R and R at 22, the Plaintiffs have adequately alleged that the innocents at PlusFunds and SPhinX would have removed the funds from RCM had they known the truth.

Recommendation on Count VII: Count VII should be dismissed with prejudice because the Plaintiffs have not adequately alleged scienter.

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[13] For reasons stated in the discussion of Counts VI and VII, the Plaintiffs' conclusory allegation that Ferris gained knowledge from auditing some Refco portfolio funds, even if it were included as an allegation for this Count, is woefully insufficient for establishing knowledge of breach of fiduciary duties.

[14] As Judge Kaplan recognized in *Fraternity Fund,* "there is some debate about whether proximate cause and substantial assistance ought to be equated in the aiding and abetting context." But most case law in the Second Circuit requires a showing of proximate cause for an aiding and abetting claim. *See, e.g., Pension Committee of University of Montreal Pension Plan v. Banc of America Securities, LLC*, 446 F.Supp.2d 163, 201 (S.D.N.Y. 2006).

D. Count XVII: Aiding and Abetting Fraud (Against both Defendants).[15]

The Counts reviewed thus far have all involved the SPhinX fraud — the unauthorized transfer of the SMFF excess cash to unprotected accounts at RCM. Count XVII involves the Refco fraud — "fraud in connection with the misrepresentation of Refco's financial condition." FAC ¶ 1256. The Special Master has found that the Plaintiffs have standing to pursue their Refco fraud claims, because the Refco Trustee was barred from bringing those claims under *in pari delicto/Wagoner*. *See* R and R on the Omnibus Issue of *in pari delicto* and Refco fraud claims, dated July 5, 2011. That R and R is currently being reviewed by Judge Rakoff. If Judge Rakoff rejects the Special Master's recommendation, then Count XVII should be dismissed for lack of standing under *in pari delicto/Wagoner*. The rest of the discussion on this Count will assume arguendo that the Plaintiffs have standing to pursue the claim.

The underlying wrong that was allegedly aided and abetted by these Defendants was the fraudulent conduct by Refco insiders in presenting a false financial picture at Refco. The Primary Wrongs R and R at 42, dated March 1, 2010 and affirmed by Judge Rakoff, concludes that "[t]he Plaintiffs have sufficiently alleged that Refco committed the primary wrong of fraud with regard to the Refco fraud." Accordingly, the Plaintiffs have sufficiently alleged a primary wrong to support the aiding and abetting claimse in Count XVII.

Count XVII contains two separate aiding and abetting claims against PwC; one of those claims includes Ferris as well. The claim against both PwC and Ferris is based on the audits for SPhinX and PlusFunds, but in this instance the Plaintiffs allege that the Defendants "gave substantial assistance to the Refco fraud by issuing unqualified audit opinions on the financial statements of SPhinX and PlusFunds, which financial statements concealed and failed to disclose the Refco fraud and the diversion and use of SPhinX cash at RCM to fund that fraud." FAC ¶ 1262. That claim is specious. The Plaintiffs make absolutely no showing that the audits — either conducted as they were or even as the Plaintiffs say they should have been — would have uncovered the Refco fraud. There is definitely no showing at all that Ferris or the PwC auditing team, by conducting the audits, became aware of the Refco fraud.[16] And as discussed above, there is no justification for arguing that the Refco advisory work should or did have some effect on the audits of SPhinX and PlusFunds. Accordingly, the claim that PwC and Ferris's work on the audits aided and abetted the Refco fraud fails utterly for lack of a showing of knowledge.[17]

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[15] Other defendants are also included in this Count but they are not before the Special Master on this motion.

[16] The Plaintiffs do not allege in this Count that Ferris's work on audits of some Refco portfolio funds provided a basis for knowing about the Refco fraud. But even if they had, the conclusory assertion would be woefully insufficient in establishing that Ferris had the requisite state of knowledge.

[17] Again for purposes of completeness, if for some reason it could be held that the Plaintiffs have sufficiently alleged that the Defendants through their audit had knowledge of the

The other aiding and abetting claim arises from the Refco advisory work and is against PwC alone — and rightly so, because there is absolutely no allegation that Ferris was involved in the Refco advisory work. As to this claim, the Plaintiffs allege that "PwC gave substantial assistance by concealing the Refco fraud, advising Refco on financial matters and preparing and approving Refco's financial statements and public filings in connection with the LBO and IPO offerings." FAC ¶ 1262. In order for that claim to survive a motion to dismiss, as discussed in the case law on aiding and abetting cited above, the Plaintiffs must allege with particularity that PwC knew about the Refco fraud and that its work advising Refco proximately cause the damages to SPhinX and PlusFunds from that fraud.

1. Knowledge of the Refco Fraud Through the Refco Advisory Work:

The Special Master finds that the Plaintiffs have adequately alleged that PwC, through its work advising Refco on the LBO and IPO, became aware of the Refco fraud. Among other specific allegations, the Plaintiffs make the following:

- As part of PwC's engagement with Refco, PwC was authorized to conduct "interviews with the outside service providers" as well as "internal personnel involved in the transactions." FAC ¶ 571 (quoting engagement letter).

- PwC's role was extended to include "advice and assistance related to the accounting and financial reporting matters for the quarter ended August 31, 2004." On November 10, 2004, PwC's engagement was further extended to "improve bottom line performance" by proposing alterations to Refco's "commissions and payouts" in numerous lines of business, including foreign exchange and prime brokerage services. FAC ¶ 572 (quoting engagement letters).

- In response to the disclosure of accounting control deficiencies at Refco, PwC was charged with "assisting in the initial planning and staffing of audits" and implementing improved accounting controls. FAC ¶ 573 (quoting engagement letter).

- Regarding the LBO, PwC was engaged by RGL to provide an assortment of services in connection with Refco's preparation of the Form S-1, including (a) assistance in drafting and reviewing the Form S-1, (b) "consultation on disclosures within the Form S-1 and the Company's financial statements", (c) providing Refco's management with support in preparing any "Underwriters' comfort letter" and (d) assisting Refco with draft responses to SEC comments. ¶ 574. PwC was also engaged by RGL in the Summer of 2004 to provide tax-consulting services and, on April 1, 2005, was engaged to prepare Refco's 2004 state and

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Refco fraud, then it is plausible to believe that their disclosure of that fact in their audits would have caused the innocents at PlusFunds and SPhinX to remedy the situation. Thus, the aiding and abetting claim regarding the audits should not be dismissed for failure to allege substantial assistance. But it should definitely be dismissed for failure to adequately allege the knowledge requirement for a cause of action for aiding and abetting.

federal tax returns. FAC ¶ 575.

● On November 22, 2004, Victor Zarate, Refco's Assistant Controller sent Henri Steenkamp, manager of PwC Global Capital Markets, a schedule of the BAWAG transactions, referred to as "BAWAG deposits." The schedule listed the exact sum of money Refco deposited in BAWAG to fund the transfer to reduce the RGHI receivable — referred to in this litigation as Round Trip Loans. The "deposits" were each made at the end of Refco's fiscal year — the last day of February for the years 2001, 2002, 2003 and 2004, and also around the time of the LBO, in July and August of 2004. FAC ¶ 584.

● PwC responded to the Zarate email listing the BAWAG deposits by asking for "the RGHI loan balances as well for th[ose] periods". The Plaintiffs plausibly allege that the tie-in between the BAWAG deposits and the RGHI loan balances demonstrates that PwC understood that the RGHI receivable was being reduced by the amounts being deposited at BAWAG. ¶ 585.

● On two of the seven dates indicated in PwC's email response to Zarate — July 31, 2004, and August 31, 2004 — for which PwC requested the RGHI loan balances, there were no RTLs in effect. Thus, Zarate's response to PwC's request for the RGHI loan balances for these two dates would have shown PwC the full magnitude of the RGHI receivable. FAC ¶ 586. PwC in its advisory work would have been familiar with Refco's financial reporting periods. Thus the response to the email question about balances would indicate that at the end of each annual reporting period, and just before the LBO, Refco was "depositing" money with BAWAG and that, concurrently, the RGHI Receivable was being reduced by a like amount. FAC ¶ 587.

● PwC prepared and/or reviewed and commented on Refco's initial S-4 registration statement, which mischaracterized the $105 million receivable from RGHI as a "customer receivable". While the SEC forced Refco to change the S-4 registration statement to reflect that the receivables were due from "equity members," the final S-4 did not disclose that the $105 million was only a portion of the overall amount owed by RGHI to Refco. FAC ¶ 594.

● PwC chose not to require disclosure of any portion of the RGHI Receivable in the S-1 registration statement prepared and filed with the SEC in connection with Refco's IPO, even though PwC did not receive, or seek, any confirmation that the $105 million receivable from RGHI disclosed in the S-4 had, in fact, been paid down, or that there were no other material related-party receivables due from RGHI and others. FAC ¶ 595.

● In connection with commenting on the consolidated financial statements that would be attached to the offering prospectus, PwC edited Refco's Note K-Related Party Transactions and characterized the $105 million receivable from RGHI as a receivable "from customers." Thus PwC mischaracterized the related-party nature of even the small amount of the receivable from RGHI that was disclosed. FAC ¶ 596.

● PwC was responsible for assisting Refco with the LBO and IPO offering materials and the financial reports and registration statements prepared and filed in connection with the LBO and IPO, including the S-1 and the S-4 registration statements. These materials included Refco's consolidated financial statements, which PwC must have reviewed given that PwC was providing Refco with advice in connection with these very documents. Review of these documents would uncover the "payable to customers" line item on the condensed consolidated financial information contained in those materials and that the amount referred to intercompany loans. FAC ¶599.

● Refco's consolidated financial statements disclosed that there were billions of dollars in intercompany transfers of which $2 billion would have had to have come from RCM. Given its work on the LBO, PwC would be aware that the approximately $2 billion in payables were owed by RGL and its affiliates to RCM as of the time of the LBO and that these amounts were not repaid in the LBO. FAC ¶ 600.

● In its role as Refco's financial reporting advisor, PwC reviewed RCM's financial statements which, given PwC's understanding that receivables from related parties were booked as receivables "from customers," would have indicated to PwC the extent to which RCM's assets were being transferred to its affiliates. FAC ¶ 601.

● PwC's comment to Refco's consolidated financial statements was to eliminate from "Summary of Significant Accounting Policies (Note B) - Receivable from and Payable to Brokers, Dealers and Customers" and move to "Related Party Transactions (Note K)" the following language: "In the normal course of business, a member of the Group engages in customer-related activities which result in receivable from or payable to customer balances, which change daily." The logical reason for moving this language to the related-party section of the financial statements before the LBO was a recognition that "payables to customer balances" referenced RCM customer assets. FAC ¶ 602.

● Through its work on the LBO combined with its advisory services and access to information, PwC would be aware that RGL would be assuming $1.4 billion of debt as a result of the LBO and that this money would be paid out to the Insiders, thereby impairing RGL's and its affiliates' ability to repay RCM. FAC ¶ 603.

● On October 12, 2005, two days after the RGHI Receivable had been publicly disclosed, PwC agreed to allocate BAWAG's 10% distributive share of RGL's 2004 income to RGHI based on Bennett's oral representation that the BAWAG affiliate that held a 10% interest in RGHI had merged into RGHI. An investigation would have caused PwC to conclude that the merger of this BAWAG affiliate into RGHI occurred on August 5, 2004, eight months into the tax year, making redistribution of BAWAG's 10% share for the entire tax year inappropriate. Yet PwC relied on the oral instructions of Bennett, who was on indefinite leave from Refco by that time, without undertaking any investigation of its own. FAC ¶¶ 604-605.

These extensive allegations indicate that PwC took on a number of important tasks which would have disclosed to PwC the basics of the Refco fraud — most particularly that a) suspiciously timed transactions were being used to hide the related party receivable; b) the LBO rendered Refco hopelessly insolvent; and c) RCM didn't have anywhere near enough assets to pay its customers. It is true, as PwC points out, that it was not Refco's auditor. But assuming the truth of the allegations, PwC's role in providing advice and in reviewing financial statements was substantial. Moreover, besides simple access to information, the Plaintiffs have alleged concrete instances that — especially when taken collectively — raise plausible inferences of knowledge. The most important of these factual allegations are: 1) the email exchange with a Refco auditor regarding BAWAG audits;[18] 2) the changes made by PwC to the consolidated financial statements regarding related party payments; 3) the non-disclosure of the RGHI receivable in the S-1 registration statement; and 4) taking Bennett's word regarding the merger of the BAWAG affiliate with RGHI. All these allegations are plausibly tied to PwC's attitude toward the misdeeds at Refco, and add significant weight to the proposition that PwC, with its various responsibilities and access to information, was aware of the Refco fraud.

PwC seeks to draw contrary, non-suspicious, inferences from the Plaintiffs' allegations, but at best PwC's spin on them creates a question of fact as to PwC's knowledge of the Refco fraud. Similarly PwC seeks to explain and downplay the nature of the services it performed for Refco but again these are arguments for a factfinder.

PwC also argues that it is implausible to believe that if it had discovered the fraud at Refco it would decide to throw in with Refco in continuing the fraud, when the only upside was the fees from the engagement and the downside was potential billions in liability. This argument is not without merit, but in light of the breadth of PwC's work and the specific allegations set forth by the Plaintiffs, it is an argument for the factfinder.

Accordingly, the Special Master finds that the Plaintiffs have sufficiently alleged PwC's knowledge of the Refco fraud.

2. Substantial Assistance of the Refco Fraud through the Refco Advisory Work.

The Plaintiffs allege that "PwC gave substantial assistance by concealing the Refco fraud, advising Refco on financial matters and preparing and approving Refco's financial statements and public filings in connection with the LBO and IPO offerings." FAC ¶ 1261. The case law above indicates that in order to state a cause of action for aiding and abetting, the Plaintiffs must show that

[18] PwC observes that Zarate was only an assistant auditor but the relevance of the information about the BAWAG transfers is not dependent on the position of the auditor in the food chain.

PwC's actions proximately caused the complained-of injuries[19] — which in this case is the loss of the $263 million that SPhinX gave back in the preference action and the loss of business value in PlusFunds. FAC ¶ 1.

The Plaintiffs claim that PwC helped conceal the Refco fraud and if SPhinX and PlusFunds had known about the Refco fraud they would have taken the cash out of RCM and ceased doing business with Refco. But the problem with the argument that PwC caused SPhinX and PlusFunds to *keep* the cash at Refco is that the information that the Plaintiffs insist should have been disclosed (and that PwC helped to conceal) was in the context of public statements, to the public at large. The Special Master reviewed a similar claim of proximate cause in the Private Actions Trust R and R, dated June 3, 2010, at 16. That R and R, affirmed and adopted by Judge Rakoff, considered the FX customers' claims that they continued to maintain assets at Refco because Grant Thornton helped to conceal the fact that Refco was hopelessly insolvent after the LBO:

> Assuming that, at the time of the LBO, RCM did disclose to its then-customers that it was hopelessly insolvent, there is nothing that those customers could have done at that point to get their money back. The announcement of hopeless insolvency would have triggered a run on RCM, in which all the company's customers would have sought to recover their funds prior to the inevitable bankruptcy filing. Because RCM, by the terms of the Trustee's complaint, had no ability to pay back the money that was upstreamed at the time of the LBO, the FX customers would have been unable to recover their funds. And those who were paid by RCM, if any, would have seen those funds recovered by the bankruptcy trustee as a voidable preference for the benefit of the estate. Consequently, FX customers who were fraudulently induced only to maintain their funds with RCM after the company became hopefully insolvent were not harmed by RCM's failure to disclose its pernicious financial position. Put another way, they were harmed by RCM's insolvency, but not by RCM's cover-up of its insolvency.

Id. (Footnotes omitted).

That analysis is equally applicable to the Plaintiffs' claims here that PwC's actions that covered up the Refco fraud caused damages because SPhinX and PlusFunds would have withdrawn the cash from Refco had they known the truth. They might well have tried — as they did when the truth was in fact disclosed — but so would (and did) everyone else. And if they got the money out in front of everyone else once PwC revealed the fraud, they would have been (and of course were in fact) subject to clawback by a preference action. Thus, the Special Master's analysis finding a lack of proximate cause regarding claims of fraudulent retention of assets at Refco bars the Plaintiffs from suing PwC for such damages here.

It is important to note the distinction in the proximate cause analyses between the damages

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[19] *Fraternity Fund Ltd. v. Beacon Hill Asset Management, LLC*, 479 F.Supp.2d 349, 370-71 (S.D.N.Y. 2007).

they seek from the Defendants regarding the Refco fraud and those they seek regarding the SPhinX fraud. Regarding the SPhinX fraud, the Plaintiffs' complaint is that PwC did not tell SPhinX and PlusFunds that the cash was sitting unprotected at RCM. Disclosure of that information would not have notified the public of the existence of a massive fraud. It would be fanciful to think that disclosure that SPhinX assets were unprotected — when made to SPhinX — would have caused a run on the bank and the collapse of Refco before the innocents at SPhinX/PlusFunds could have lawfully got the money out. But regarding the Refco fraud, the Plaintiffs' complaint is that PwC did not disclose in public filings the facts about the RGHI receivable and Refco's insolvency. As stated above, disclosure of that information would have, and in fact did, result in a run on the bank.

Accordingly, the Plaintiffs' claims against PwC for aiding and abetting the Refco fraud should be dismissed insofar as they encompass damages for SPhinX assets held at Refco before the date of the acts allegedly committed by PwC to substantially assist the Refco fraud.

The Private Action Trust R and R next considered the claims of the FX customers who placed assets with Refco *after* the wrongdoing allegedly aided and abetted occurred. Those plaintiffs had a cause of action against defendants who substantially assisted the primary wrong because they could plausibly allege that if they had known about the condition at Refco, they never would have put their money there, and then of course that money would never have been swept up in the Refco fraud in the first place. See Private Actions Trust R and R at 17. That analysis is equally applicable to the Plaintiffs' claims here — assuming that PwC's alleged actions were sufficient to conceal the Refco fraud, as the Plaintiffs claim.

On the question of whether PwC's actions were sufficient to substantially assist the Refco fraud, the Plaintiffs have adequately alleged that PwC actively assisted in concealing the RGHI receivable in a number of public statements, including the consolidated financial statements and public filings for the LBO and the IPO. The Plaintiffs provide specific allegations pertinent to SPhinX and PlusFunds reasonably relying on that misinformation in deciding to continue to place assets at Refco. For example, the Plaintiffs allege that PlusFunds' risk committee kept a "shadow rating" for Refco, reviewed public statements, and calculated guidelines to limit exposure on transactions with Refco. FAC ¶ 189. Accordingly, the Plaintiffs have adequately alleged a claim against PwC for aiding and abetting the Refco fraud, with respect to those deposits made by SPhinX/PlusFunds in Refco after the date of PwC's alleged wrongful activity. [20]

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[20] PwC argues that its conduct could not have proximately caused any of the Plaintiffs' damages, because 1) there are other wrongdoers, and 2) the SPhinX/PlusFunds decision to settle the preference action cut any chain of causation for the loss of the money clawed back in that action. The Special Master has already found , in the Krys v. Aaron R and R, that the acts of other wrongdoers do not cut the chain of causation. That finding was affirmed by Judge Rakoff. As to the relevance of the settlement of the preference action, the Special Master has already considered this argument in detail in the Owens and Kavanagh R and R at 21, and found that the settlement of the preference action does not cut the chain of causation. That R and R is before Judge Rakoff. If Judge Rakoff rejects the Special Master's finding, then the assessment of

The Special Master recognizes that the dividing line between "before" and "after" is murkier in this case than it was in the Private Actions Trust matter. Under the facts of that case, the alleged wrongful conduct that was the only basis for damages was the completion of the LBO in 2004, which rendered Refco hopelessly insolvent. The alleged wrongful conduct here is PwC's actions that substantially assisted the Refco fraud.[21] It is not necessary at this point, however, to determine the exact date that divides assets retained at Refco, which are not recoverable, from assets placed in Refco, which are. Indeed determining a date at this point is not permissible, because the date at which PwC's actions were material in concealing the Refco fraud — if at all — is unquestionably a matter for the trier of fact.

Accordingly, the Plaintiffs have adequately alleged a cause of action against PwC in one respect: as to damages sustained by placing SMFF funds with Refco after the date of PwC's concealment of the Refco fraud in its advisory work for Refco.

Recommendations on Count XVII:

1. The Plaintiffs' claim against Ferris should be dismissed with prejudice because the Plaintiffs have not adequately alleged scienter.

2. The Plaintiffs' claim against PwC for its conduct in auditing SPhinX and PlusFunds should be dismissed with prejudice because as to that claim the Plaintiffs have not adequately alleged scienter.

3. The Plaintiffs' claim against PWC for its Refco advisory work should be dismissed with prejudice for lack of proximate cause insofar as it seeks damages for the loss of assets retained at Refco after PwC's acts of aiding and abetting.

4. PwC's motion to dismiss should be denied as to the claim against PwC for conduct in its Refco advisory work that caused SPhinX/PlusFunds to place assets at Refco.

D. Count XVIII: Aiding and Abetting Breaches of Fiduciary Duty (Against PwC, but not Ferris).[22]

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proximate cause in this Report and Recommendation will need to be adjusted accordingly.

[21] It goes without saying that PwC cannot be held responsible for damages caused by the Refco fraud before PwC was retained by Refco.

[22] Other defendants are included in this Count but they are not before the Special Master on this motion.

In Count XVIII, the Plaintiffs' claim focuses on the upstreaming of assets from RCM. The Plaintiffs allege that Refco breached a fiduciary duty owed to SPhinX and PlusFunds that it violated by upstreaming customer assets at RCM, and that PwC substantially assisted the breach by its Refco advisory work and its clean audit opinions for SPhinX and PlusFunds.

1. Primary Wrong

Once again, the Plaintiffs are charged with sufficiently alleging primary wrongs. The Plaintiffs' allegation that Refco had a fiduciary duty to SPhinX and PlusFunds based on operating while insolvent has been rejected by the Special Master — *see* Primary Wrongs R and R at 34-36. So the Plaintiffs' claims in Count XVIII fail for failure to allege a primary wrong, insofar as they are based on operating while insolvent.

However, the Special Master in the Primary Wrongs R and R did find that the Plaintiffs sufficiently alleged Refco had a fiduciary duty, based on a relationship of trust and confidence, to refrain from "self-dealing — use of the SMFF excess cash at RCM to fund Refco's various operations." Primary Wrongs R and R at 37. Thus, the Plaintiffs have adequately alleged a breach of fiduciary duty by upstreaming SPhinX assets at RCM and using them to fund Refco operations.

2. Knowledge

For purposes of this Count, the Plaintiffs must adequately allege that PwC knew about the upstreaming of customer assets from RCM, *and* that it was wrongful conduct. *See Kolbeck v. LIT Am., Inc.*, 939 F. Supp. 240, 246 (S.D.N.Y. 1996) (to plead a cause of action for aiding and abetting breach of fiduciary duty, the plaintiff must allege both that "the defendant had actual knowledge of the primary violator's status as a fiduciary and actual knowledge that the primary violator's conduct contravened a fiduciary duty."). On the knowledge question, the Plaintiffs rely on two familiar sources: the audits of SPhinX and PlusFunds and the advisory services for Refco. As stated previously, the Plaintiffs' allegations that PwC during the audits learned anything about the status of the cash at RCM are deficient because the FAC belies that assertion, and nothing in the Complaint supports an inference of actual knowledge. Therefore, for the Plaintiffs to withstand the motion to dismiss, the knowledge of breach of fiduciary duty must come from the Refco advisory work if it comes from anywhere.

The question then is whether the Plaintiffs have sufficiently alleged that, in the course of its Refco advisory work, PwC became aware of the upstreaming from RCM and knew that it was a breach of fiduciary duty to take the money out of RCM. It must be remembered that the Plaintiffs must allege not only that PwC was aware of the upstreaming but also that PwC knew the upstreaming was wrongful. *See In re Sharp Intern. Corp.*, 403 F.3d 43, 49 (2nd Cir. 2005) (for a claim of aiding and abetting breach of fiduciary duty there must be an allegation that the defendant had "actual knowledge of the breach of duty"). Thus it is not enough to allege facts indicating that PwC knew that assets were being upstreamed out of RCM, because the transfers out of RCM could well have been consistent with Refco's duties to its customers. Indeed Judge Lynch held that at least

as to the FX accounts, the upstreaming of the funds out of RCM did not violate any fiduciary duty because the Margin Annex permitted the upstreaming. *See Kirchner v. Bennett*, 648 F. Supp. 2d 525 (S.D.N.Y. 2009). Similarly, the Private Actions Trust R and R, at 22, found that the Plaintiffs' allegations about upstreaming the FX deposits out of RCM did not establish a breach of fiduciary duty. The question then boils down to whether PwC, during the course of its advisory work at Refco, came to know *both*: 1) that assets were being upstreamed from RCM, *and* 2) that Refco had a relationship of trust and confidence with SPhinX/PlusFunds that would bar that self-dealing. In the absence of that second finding, PwC would have no reason to know that the upstreaming was wrongful — indeed it would be completely unfair to hold PwC liable for knowing about the bare fact of the upstreaming when two courts in this district have held that the upstreaming was not a wrong in itself.

The Plaintiffs do allege that PwC, in the course of its Refco advisory work, learned about the upstreaming of assets out of RCM. In particular they make the following allegations:

- The volume and size of the transfers from RCM customer accounts, involving, on many occasions, hundreds of millions of dollars each, ensured that the amount of RCM funds that were "loaned" to other entities substantially outsized Refco's total capital. By the time Refco filed for bankruptcy, the net uncollectible transfers totaled $2 billion, while RGL claimed only $515 million in capital in 2002, $566 million in 2003, $616 million in 2004 and only $150 million in 2005. FAC ¶ 598.

- PwC knew that the only Refco operating entity that was maintained as a purportedly unregulated entity — and so a source of customer funds — was RCM. Refco's consolidated financial statements, which were reviewed by PwC as part of its services, disclosed that there were billions of dollars in consolidating intercompany transfers of which $2 billion would have had to have come from RCM. FAC ¶ 600.

As with the discussion of PwC's scienter under Count XVII regarding the Refco fraud, the Plaintiffs have plausibly alleged that PwC, because of its access to information and the breadth of its services, was aware of the upstreaming of customer assets from RCM. Particularly compelling are the allegations that PwC reviewed the consolidated financial statements, and the difference between the amount of the intercompany transfers and the actual amount of capital at RGL.

The problem for the Plaintiffs is with the additional requirement that PwC knew that the transfers out of RCM were a breach of Refco's breach of fiduciary duty. The Plaintiffs allege that as a result of its Refco advisory services, "PwC was in a unique position and became aware of all the facts giving rise to fiduciary duties owed by Refco and its agents to SPhinX * * * and PlusFunds, including but not limited to the fact that Refco was acting as custodian of SPhinX customer funds." FAC ¶ 576. But it is implausible to believe that PwC, even with the access given during its advisory services, would learn about the relationship of trust and confidence with SPhinX and PlusFunds that triggered a fiduciary duty on Refco's part. The Plaintiffs claim a fiduciary duty based on Refco being a custodian of SPhinX customer funds, but in the Private Actions Trust R and R at 21-22, the Special Master (affirmed by Judge Rakoff) found that Refco's custody of and waste

of the FX customer accounts was *not* a breach of fiduciary duty. The Special Master reasoned that "[a]ny finding of a fiduciary duty to disclose the misuse and non-return of funds must fall short if the Margin Annex says that RCM could use the funds for any purpose." Id. It is true that in the Primary Wrongs R and R at 26-27, the Special Master found that the Margin Annex did not foreclose the Plaintiffs' claim that the excess cash was entitled to a right of segregation. But the narrow distinctions in how the Margin Annex applied or did not apply to funds at a Refco subsidiary were surely not within PWC's information base even though it had access to a good deal of information about Refco.

Accordingly the Plaintiffs have failed to adequately allege the scienter required for aiding and abetting a breach of fiduciary duty.

3. Substantial Assistance

In reviewing Count XVII for aiding and abetting fraud, the Special Master determined that the Plaintiffs have adequately alleged that PwC substantially assisted the Refco fraud but only insofar as it applied to assets deposited with Refco after the date of PwC's wrongful activity. The same analysis applies to the upstreaming of assets. If PwC had disclosed the millions of dollars of assets being upstreamed to fund Refco, that information would have been relied on by members of the public and the same scenario would have occurred as did occur. Therefore, assuming arguendo that the Plaintiffs have adequately alleged scienter, PwC's alleged concealment of the RCM customer scheme proximately caused the loss of any investment made after PwC's wrongful acts, but did not proximately cause the loss of assets that were placed at Refco before PwC's conduct and held at Refco after it.

Recommendation on Count XVIII: The claims against PwC should be dismissed with prejudice because the Plaintiffs have not adequately alleged scienter.

F. Count XIX: Aiding and Abetting Conversion (Against Both Defendants)[23]

The claim here is that Refco converted the SMFF assets and that the Defendants substantially assisted the conversion by concealing the Refco fraud through the Refco advisory work and the clean audit opinions for SPhinX and PlusFunds.

1. Primary Wrong:

[23] Other defendants are included in this Count but they are not before the Special Master in this motion.

In the Primary Wrongs R and R at 41, the Special Master stated that "[u]nder the liberal pleading standards of Rule 8, the Plaintiffs have stated a plausible account of 'unauthorized dominion' over the SMFF excess cash. And certainly they have alleged that Refco exercised dominion to the exclusion of the Plaintiffs' rights — the cash was supposed to be segregated and then it was gone." Thus the Plaintiffs have adequately alleged the primary wrong of conversion.

2. Knowledge:

The analysis here tracks the analysis of the claims for aiding and abetting breach of fiduciary duty in Count XVIII. As applicable to PwC, the Counts are worded identically, the only difference being the primary wrong. Applying the analysis from previous Counts to this case leads to the following conclusions regarding scienter:

- The Plaintiffs have failed to adequately allege that Ferris knew about the conversion of the SMFF cash because: a) nothing in the scope of the SPhinX/PlusFunds audits would have led Ferris to figure out that the cash was completely unprotected at RCM; b) nothing about the Refco advisory work, in which she was not involved could have given her any relevant information because she was not involved in that work; and c) nothing about her audits of Refco portfolio funds would have disclosed that funds from an unrelated account were unprotected.

- The Plaintiffs have failed to adequately allege that PwC knew that the excess cash was converted by Refco because: a) the Refco advisory work would plausibly have given it knowledge about the transfers out of RCM, but there is nothing to indicate that PwC would know that those transfers were unauthorized — as the question of authorization is a murky one based on the Margin Annex, segregation requirements, and other factors well beyond the knowledge of PWC; b) nothing in the scope of the SPhinX/PlusFunds audits would have led Ferris to figure out that the cash was completely unprotected at RCM; and c) nothing learned by PwC in the Refco advisory work was or should have been provided to the audit teams for SPhinX/PlusFunds.

Accordingly, the Plaintiffs have failed to adequately allege scienter as to either of the Defendants.

3. Substantial Assistance:

As discussed with other counts, *if* the Defendants had knowledge of the upstreaming of customer funds, their disclosure of that information would plausibly have caused remedial action by the victims, and so the concealment of that information substantially assisted the wrong, at least in part. In reviewing Count XVII for aiding and abetting fraud, the Special Master determined that the Plaintiffs have adequately alleged that PwC substantially assisted the Refco fraud but only insofar as it applied to assets deposited with Refco after the date of PwC's wrongful activity. The same analysis applies to the upstreaming of assets. If PwC had disclosed that millions of dollars of assets were being upstreamed to fund Refco, that information would have been relied on by members of the public and the same scenario would have occurred as did occur. Therefore, assuming

scienter, PwC's alleged concealment of the RCM customer scheme proximately caused the loss of any investment made after its wrongful acts, but not did not cause the loss of any assets that were placed at Refco before the conduct and held at Refco after it.

The analysis is different with respect to information about the excess cash being completely unprotected at RCM. The disclosure of that information could plausibly have led the innocents at PlusFunds and SPhinX to withdraw the money. But it would not have led to a run on the bank as it was information directed to, and affecting only, a single set of investors. Thus, concealment of that part of the conversion proximately caused all the damages suffered by SPhinX and PlusFunds.

Recommendation on Count XIX: The claims against PwC and Ferris should be dismissed with prejudice because the Plaintiffs have not adequately alleged scienter.

III. Conclusion

The Special Master makes the following recommendations:

With respect to Count VI:

This Count should be dismissed in its entirety with prejudice.

With respect to Count VII:

This Count should be dismissed in its entirety with prejudice.

With respect to Count VIII:

This Count should be dismissed in its entirety with prejudice.

With respect to Count XVII:

1. The Plaintiffs' claim against Ferris should be dismissed with prejudice because the Plaintiffs have not adequately alleged scienter.

2. The Plaintiffs' claim against PwC for its conduct in auditing SPhinX and PlusFunds should be dismissed with prejudice because as to that claim the Plaintiffs have not adequately

alleged scienter.

3. The Plaintiffs' claim against PWC for its Refco advisory work should be dismissed with prejudice for lack of proximate cause insofar as it seeks damages for the loss of assets retained at Refco after PwC's acts of aiding and abetting.

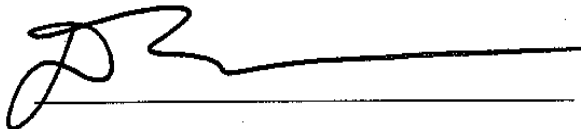
4. PwC's motion to dismiss should be denied as to the claim against PwC for conduct in its Refco advisory work that caused SPhinX/PlusFunds to place assets at Refco.

With respect to Count XVIII:

The claims against PwC should be dismissed with prejudice.

With respect to Count XIX:

The claims against PwC and Ferris should be dismissed with prejudice.



Daniel J. Capra
Special Master

Dated: August 10, 2011
New York, New York