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SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: MELVIN L. SCHWEITZER **PART** 45
Justice

ALEXANDER DAWSON FOUNDATION, et al **INDEX NO.** 650053/11

MOTION DATE ______

- v -

MOTION SEQ. NO. 005

BRIAN F. ZUCKER, et al **MOTION CAL. NO.** ______

The following papers, numbered 1 to ______ were read on this motion to/for ______

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	
Answering Affidavits — Exhibits	
Replying Affidavits	

Cross-Motion: ☐ Yes ☐ No

Upon the foregoing papers, it is ordered that ~~this~~ these motions to dismiss are granted in part and denied in part per the attached Decision and Order.

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

Dated: February 15, 2012

[signature] J.S.C.

Check one: ☐ FINAL DISPOSITION ☑ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

☐ SUBMIT ORDER/JUDG. ☐ SETTLE ORDER /JUDG.

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK : PART 45

ALEXANDER DAWSON FOUNDATION, ET AL., Plaintiffs, -against- BRIAN F. ZUCKER, ET AL., Defendants.	Index No. 650053/11 DECISION AND ORDER Motion Sequence Nos. 004, 005 and 006

MELVIN L. SCHWEITZER, J.:

All defendants have filed a motion to dismiss the complaint pursuant to CPLR 3211 (a) (1), (a) (5), and (a) (7).

Background

This dispute arises out of an acknowledged scheme by Mark Bloom (Mr. Bloom) to defraud the investors in a hedge fund, North Hills, L.P. (North Hills). Plaintiffs are the Alexander Dawson Foundation and its investment arm, Alexander Dawson Inc. (ADI Plaintiffs); Mario P. Borini and Bianca C. Borini, individually and as trustees of their personal trusts, and Joseph C. Borini (Borinis). Mario and Joseph Borini are trustees and directors of ADI Plaintiffs. All Plaintiffs are limited partners in North Hills.

Defendants Glenn E. Davis (Mr. Davis), Robert M. Graber (Mr. Graber), and Davis, Graber, Plotzker & Ward LLP (DGPW) were engaged to audit North Hills' financial statements for the fiscal years 2001–2004. Each opinion issued by DGPW noted substantial distributions taken from the fund by Mr. Bloom and the existence of notes receivable purporting to cover those distributions. Each opinion was qualified by reference to such distributions and notes.

On March 5, 2004, the Board of Directors of ADI telephoned Mr. Graber to discuss the financial condition of North Hills. Between April 2004 and January 2005, all plaintiffs invested additional sums in North Hills. Plaintiffs do not describe any investments made after January 2005.

During the summer of 2005, while auditing North Hill's 2004 fiscal year financial statements, DGPW discovered that the securities pledged by Mr. Bloom to cover the distributions were not in the file. DGPW withdrew from the audit engagement and recalled its 2003 opinion.

In addition, DGPW prepared the Borinis' personal tax returns for the years 2000–2007.

Defendant Rosenzweig (Mr. Rosenzweig) was a director of the general partner of North Hills. In June or July 2005, Mr. Rosenzweig learned that Mr. Bloom had taken substantial distributions from North Hills, as well as unlawful commissions on one of the fund's investments. Mr. Rosenzweig recommended that North Hills be liquidated, and that Mr. Bloom should personally guarantee a note to the fund for the amount of the distributions. On November 3, 2005, Mr. Rosenzweig resigned from his position as director.

Defendants Brian Zucker (Mr. Zucker) and Zucker & Associates, LLP (Zucker) provided tax documents for the fund, including Schedule K-1s, for the years 2004–2007. Plaintiffs did not receive the 2004 Schedule K-1 until after January 2005, the last date of their investments.

Plaintiffs have brought claims against the three groups of defendants including fraud, breach of fiduciary duty, negligent misrepresentation, accountant malpractice, and aiding and abetting fraud and breach of fiduciary duty. Defendants respond with motions to dismiss on a variety of grounds.

Discussion

In a motion to dismiss under CPLR 3211 (a), "the court will accept the facts as alleged in the complaint as true, accord plaintiffs the benefit of every possible favorable inference, and determine only whether the facts as alleged fit within any cognizable legal theory." *Nonnon v City of New York*, 9 NY3d 825, 827 (2007) (quotation marks omitted). However, "allegations consisting of bare legal conclusions, as well as factual claims that are inherently incredible or flatly contradicted by documentary evidence" are not presumed true. *Kaisman v Hernandez*, 61 AD3d 565, 566 (1st Dept 2009).

I. Plaintiffs' "holder" claims are speculative and must be dismissed

Many of plaintiff's claims for damages rest on the assertion that defendant's actions induced them to continue to hold an investment that, if they were in possession of certain facts, they would otherwise have sold.

The First Department recently has rejected just such a "holder" claim as unduly speculative. *Starr Foundation v American International Group, Inc.*, 76 AD3d 25 (1st Dept 2010). Under *Starr Foundation*, "the loss of an alternative contractual bargain . . . cannot serve as a basis for fraud or misrepresentation damages because the loss of the bargain was undeterminable and speculative." *Id.* at 249 (quotation marks omitted). A claim of inducement to hold an investment is based on a hypothetical claim about what value the investor could have recovered from his investment if he had acted earlier, requiring multitudes of assumptions and unprovable claims about what plaintiff would or would not have done in counterfactual situations. In this case, calculating damages would require speculating not only about what plaintiffs would have done in response to the information about Mr. Bloom's fraud, but also

about the actions of other investors, Mr. Bloom, law enforcement, and perhaps even a bankruptcy court.

Plaintiffs' final investment in North Hills occurred in January 2005, before any of Mr. Rosenzweig's alleged wrongful acts. As a result, plaintiffs' only claims against him are also based on a theory of inducement to hold, and so must be dismissed as speculative.

Plaintiffs' claims against Mr. Zucker relating to their North Hills investment are likewise speculative. Finally, plaintiffs' claims against DGPW must be dismissed to the extent they are based on the investments they already held before DGPW allegedly induced them to invest further sums.

II. Plaintiffs' claims against DGPW relating to its North Hills audit engagement are dismissed in part

A. Plaintiffs' claims are based on a theory of direct misrepresentations and so are not derivative

DGPW claims that plaintiffs lack standing because they seek damages for the diminution in value of their investments, a claim that may only be brought derivatively on behalf of the corporation. *See Abrams v Donati*, 66 NY2d 951 (1985). However, a claim may be brought directly when "the wrongdoer has breached a duty owed to the shareholder independent of any duty owing to the corporation wronged." *Id.* at 953. Plaintiffs allege that DGPW breached its duty to speak truthfully under the circumstances by making direct misrepresentations about North Hills' financial situation. Accordingly, plaintiffs' claims survive to the extent that they are based on inducement to invest by misrepresentations.

B. Plaintiffs' claims against DGPW are not barred by the statute of limitations

ADI plaintiffs are residents of Nevada, and so the shorter of New York or Nevada's statute of limitations applies. CPLR 202. The Borinis are residents of New York, and so New York law applies. Under both New York and Nevada law, the limitations period begins running when the facts giving rise to the cause of action are discovered or "could with reasonable diligence have been discovered." CPLR 203(g). *See* NRS 11.190(3)(d). Furthermore, the limitations period does not run from when the plaintiff discovers the existence of a fraudulent scheme, but when the plaintiff had "knowledge of facts suggesting a particular defendant's participation." *AE Liquidation Corp. v Segre*, 96 Civ. 0889 CSH, 2000 WL 204525, *7 (SDNY Feb. 18, 2000); *see also Rostuca Holdings, Ltd. v Polo*, 231 AD2d 402, 402 (1st Dept 1996); *City of N.Y. v Morris J. Eisen P.C.*, 641 NYS2d 257, 258 (1st Dept 1996).

Controversy centers on when plaintiffs would, with "reasonable diligence," have discovered DGPW's alleged role. DGPW claims that plaintiffs had access to all relevant facts no later than 2004, when they resolved to invest in North Hills and had financial statements for fiscal years 2001–2003 available to them. If plaintiffs were not aware of facts leading them to infer DGPW's alleged role by 2004, DGPW claims, they failed to exercise reasonable diligence and their claims should be barred by the statute of limitations.

Plaintiffs respond that they did exercise reasonable diligence, particularly by contacting DGPW before making further investments in March 2004. Furthermore, any duty of diligence is reduced when a party relies on a fiduciary. *See Frame v Maynard*, 83 AD3d 599, 602 (1st Dept 2011); *Golden Nugget, Inc. v Ham*, 95 Nev. 45, 49 (1979). Plaintiffs were justified in relying on

Mr. Bloom as their fiduciary until they discovered his fraudulent scheme in 2008. DGPW poses an argument regarding the reasonableness of plaintiff's inquiry in 2004. This is not appropriately dealt with on a motion to dismiss. Consequently, the motion to dismiss is denied.

C. DGPW was not a fiduciary and so plaintiffs have not stated a claim for breach of fiduciary duty

Plaintiffs allege that DGPW breached a fiduciary duty. However, plaintiffs have not set forth allegations which substantiate creation of this duty. In general, the relationship between an accountant and client is not fiduciary, but purely commercial. *DG Liquidation, Inc. v Anchin, Block & Anchin, LLP*, 300 AD2d 70 (1st Dept 2002). *See also Fund of Funds, Ltd. v Arthur Andersen & Co.*, 545 F Supp. 1314, 1356 (SDNY 1982).

While this relationship may not ordinarily give rise to a fiduciary duty, it may in special circumstances. Plaintiffs cite one case of New York courts speculating on a possible fiduciary duty "where the allegations include knowledge and concealment of illegal acts and diversions of funds and failure to withdraw in the face of a conflict of interest." *Nate B. & Frances Spingold Found. v Wallin, Simon, Black & Co.*, 184 AD2d 464, 465 (1st Dept 1992). Even if the court chose to follow *Nate B's* dicta, the allegations against DGPW do not reach this bar; plaintiffs do not allege that DGPW diverted funds or failed to properly withdraw.

A survey of more recent cases reveals that courts generally set a high bar for finding the creation of a fiduciary duty based on "special circumstances," requiring some showing that the relationship changed qualitatively to one where the accountant exercised some form of control over the client's assets. *L. Magarian & Co., Inc. v Timberland Co.*, 245 AD2d 69, 70 (1st Dept 1997) (describing "special circumstances' that could have transformed the parties' business

relationship to a fiduciary one, such as control by one party of the other for the good of the other or creation of an agency relationship"); *Lavin v Kaufman, Greenhut, Lebowitz & Forman*, 226 AD2d 107, 108 (1st Dept 1996) (finding a fiduciary duty where "plaintiff trusted the individual defendant, her accountant, who made all investment decisions for her from 1976 to 1992, and she always followed his advice and routinely signed whatever financial or tax documents he suggested"). While plaintiffs may have had great confidence in DGPW, DGPW did not exercise any element of control over plaintiffs' assets and provided only normal business services. Plaintiffs have not described special circumstances in this instance sufficient to create a fiduciary duty.

D. DGPW's other arguments for dismissal fail

1. Plaintiffs have pled sufficient scienter to state a claim for fraud

To state a claim for fraud, plaintiffs must demonstrate "misrepresentation of a present or pre-existing fact known to be untrue by the party making it with the intent to deceive and for the purpose of inducing the other party to act upon it causing injury." *Roney v Janis*, 77 AD2d 555, 556-57 (1st Dept 1980). CPLR 316 (b) requires that all elements, including the element of scienter, be pled with specificity; a "mere conclusory assertion of recklessness and intent" will not meet this heightened pleading standard. *Marine Midland Bank v Grant Thornton LLP*, 260 AD2d 318, 319 (1st Dept 1999). In judging what level of detail will meet this standard, the First Department has stated that "plaintiffs need only set forth sufficient information to apprise defendants of the alleged wrongs." *DDJ Mgmt., LLC v Rhone Group L.L.C.*, 78 AD3d 442, 443 (1st Dept 2010). Finally, a fraud pleading against an accountant does not need to contain "more

than a particularized factual assertion which supports the inference of scienter." *Houbigant, Inc. v Deloitte & Touche LLP*, 303 AD2d 92, 98 (1st Dept 2003).

Plaintiffs' complaint meets this pleading standard. Plaintiffs have alleged specific actual knowledge on the part of DGPW, including reference to a ledger that DGPW reviewed while preparing the 2003 audit. While DGPW disputes the allegation of actual knowledge presented in the complaint, plaintiff's pleadings, read in a favorable light, support the inference of scienter.

2. Plaintiffs have stated a claim for aiding and abetting fraud, and aiding and abetting breach of fiduciary duty

The elements of aiding and abetting fraud are "(1) the existence of an underlying fraud; (2) knowledge of this fraud on the part of the aider and abettor; and (3) substantial assistance by the aider and abettor in achievement of the fraud." *Stanfield Offshore Leveraged Assets, Ltd. v Metro. Life Ins. Co.*, 64 AD3d 472, 476 (1st Dept 2009) (quotation marks omitted). To the extent that the defendant must act with the intent of aiding the fraudulent scheme, the intent requirement is satisfied by "the proposed aider's knowledge of the fraud." *Nat'l Westminster Bank USA v Weksel*, 124 AD2d 144, 149 (1st Dept 1987). The cause of action does not require allegations that the defendant conspired, benefitted from the fraud, or intended to cause harm. *See Houbigant*, 33 AD2d at 100.

DGPW claims that plaintiffs have not adequately pled a "nexus" between DGPW and the fraud (including that plaintiffs do not allege that DGPW conspired or explain how DGPW would benefit from aiding the fraud). However, the types of allegations that DGPW claim are lacking from the complaint are not actually required for the cause of action.

A claim of aiding and abetting a breach of fiduciary duty requires the defendant's knowing participation in the breach. More specifically, "a person knowingly participates in a breach of fiduciary duty only when he or she provides 'substantial assistance' to the primary violator." *Kaufman v Cohen*, 307 AD2d 113, 126 (1st Dept 2003). Plaintiffs once again have met this pleading standard, alleging facts that constitute substantial assistance to Mr. Bloom's perpetration of the fraud.

3. DGPW was in near-privity with plaintiffs, and so plaintiffs have stated a claim for negligent misrepresentation

An accountant generally has a duty of care in the performance of accounting services only to the party it has contracted with for those services. *Sec. Pac. Bus. Credit, Inc. v Peat Marwick Main & Co.*, 79 N.Y.2d 695, 702 (1992). However, "accountants may also incur liability to injured third parties who rely on their work." *Id.* The New York Court of Appeals has articulated this doctrine of near-privity as follows:

> (1) the accountants must have been aware that the financial reports were to be used for a particular purpose or purposes; (2) in the furtherance of which a known party or parties was intended to rely; and (3) there must have been some conduct on the part of the accountants linking them to that party or parties, which evinces the accountants' understanding of that party or parties' reliance.

Credit Alliance Corp. v Arthur Andersen & Co., 65 NY2d 536, 551 (1985).

While DGPW did not owe a fiduciary duty to plaintiffs, it was in near privity with them sufficient to support their claim of negligent misrepresentation. The three elements are satisfied here; DGPW was aware that its audit reports would be used (1) by North Hills' limited partners, (2) for the particular purpose of evaluating the financial health of the fund, and (3) the 2004 phone call links DGPW to plaintiffs.

Specifically, "accountants retained by a limited partnership to perform auditing and tax return services may be held responsible to an identifiable group of limited partners for negligence in the execution of those professional services." *White v Guarente*, 43 NY2d 356, 358 (1977). The facts in *White* closely parallel the present case: a limited partner claimed that the accountants violated their professional duty by failing to notify the limited partners of the general partner's improper withdrawal of funds.

Defendants point out that New York courts have refused to extend near-privity when the facts involve a "single phone call," *Sec. Pac. Bus. Credit, Inc. v Peat Marwick Main & Co.*, 79 NY2d 695, 705 (1992), or a "third party's reliance on alleged verbal assurances," *Lampert v Mahoney, Cohen & Co.*, 218 AD2d 580, 582 (1995). The facts of these two cases are significantly different; both involve outside lenders attempting to establish near-privity with a debtor's accountant. The current case involves limited partners and an accounting firm that prepared audit reports specifically for the limited partners' intended use, a far closer fit to the first prong of the *Credit Alliance* decision. Plaintiffs' claims against DGPW are not to be dismissed for lack of privity.

4. Alleged failure to plead reliance

Finally, DGPW contests several of these causes of action based on the unreasonableness of plaintiff's reliance on the March 4, 2004 phone call. However, on a motion to dismiss the court will give plaintiffs the benefit of every inference. *See Leon v Martinez*, 84 NY2d 83, 87 (1994). They have specifically pled reliance on DGPW's representations. Accordingly, plaintiffs' claims against DGPW will not be dismissed for failure to plead reliance.

III. Claims related to the Borinis' tax returns survive to the extent that they fall within the statute of limitations

The Borinis have stated a claim for accountant malpractice against DGPW based on damages caused by inaccuracy of their personal tax returns. Because these claims arise from the improper payment of taxes, they cannot be dismissed as claims pertaining to the holding of an investment. The claim can be sustained because DGPW was in near privity with the plaintiffs, as discussed *supra*.

DGPW contends that Borinis have not identified any act of malpractice because professional ethics rules prohibited it from sharing any information about North Hills without North Hills' consent. However, the Borinis have based their claim not on DGPW's silence but on what they allege to be its affirmative misrepresentations. A professional duty of non-disclosure cannot overcome liability for "affirmative negligent misstatements of fact." *First Fed. Sav. & Loan Ass'n of Pittsburgh v Oppenheim, Appel, Dixon & Co.*, 629 F Supp 427, 435 (SDNY 1986).

The remaining question regarding this claim is to what extent it has been made within the statute of limitations. The Borinis are New York residents, and so their claims are subject only to the New York statute of limitations, which for professional malpractice in New York is three years. CPLR 214 (6). The limitations period runs from the time the client receives the professional's work product. *Ackerman v Price Waterhouse*, 84 NY2d 535, 541 (1994). All parties agree that the claims arising from the Borinis' 2007 tax returns fall within this limitations period.

The statute of limitations may be tolled if any part of a "course of continuous representation" falls within the limitations period. *Ackerman v Price Waterhouse*, 252 AD2d 179 (1st Dept 1998). However, in the closest factual analogue to the current case, the First Department has held that successive years of tax preparation constitute a "series of discrete and severable transactions" rather than a continuous representation, even if the same error is repeated in each year. *Booth v Kriegel*, 36 AD3d 312, 313 (1st Dept 2006). Mr. Zucker's preparation of K-1s and DGPW's preparation of the Borinis' tax returns occurred in a series of discrete transactions, and so only claims arising from the 2007 tax year fall within the statute of limitations.

Conclusion

Plaintiffs claims against DGPW in connection with the North Hills audit engagement for fraud, aiding and abetting fraud, aiding and abetting breach of fiduciary duty, and negligent misrepresentation survive the motion to dismiss to the extent that damages are based on inducement to invest, not inducement to hold an investment. The Borinis' claims against DGPW in connection with their 2007 tax returns survive. All other claims are dismissed.

Accordingly, it is

ORDERED that defendant DGPW's motion to dismiss claims relating to its audit engagement is denied, except to the extent damages are based on inducement to continue to hold an investment; and it is further

ORDERED that defendant DGPW's motion to dismiss claims by the Borinis relating to their 2007 tax returns is denied; and it is further

ORDERED that all other claims by plaintiffs are dismissed.

Dated: February 6, 2012

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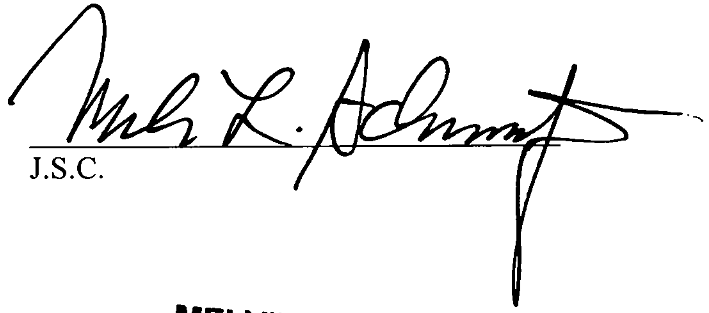

J.S.C.

MELVIN L. SCHWEITZER
J.S.C.