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

PRESENT: BERNARD J. FRIED, Justice — PART 60

E-FILE

Apple Bank for Savings,

Plaintiff,

- v -

PriceWaterHouseCoopers,

Defendant.

INDEX NO. #603492-2008

MOTION DATE

MOTION SEQ. NO #004

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

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

This motion is decided in accordance with the accompanying memorandum decision.

A status conference will be held on **June 23, at 9:30 a.m**, in Part 60.

Two boxes of Exhibits are in the courtroom (248), available to be picked up, if desired, by the respective parties. If not retrieved by the c.o.b., Wednesday, May 20, 2009, they will be **discarded.**

SO ORDERED

FILED
May 15 2009
NEW YORK
COUNTY CLERK'S OFFICE

NYS SUPREME COURT E-FILED AS DOCUMENT #

Dated: 5/14/09

HON. BERNARD J. FRIED

Check one: ☐ FINAL DISPOSITION ☒ NON-FINAL DISPOSITION

☐ DO NOT POST [ ] REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: I.A.S. PART 60
---X
APPLE BANK FOR SAVINGS.,

Plaintiff,

-against-

Index No. 603492/06

PRICEWATERHOUSECOOPERS, LLP,

Defendant.
---X
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FRIED, J:

In this action alleging accounting malpractice, defendant, PricewaterhouseCoopers, LLP ("PWC") moves pursuant to CPLR 3212 for summary judgment dismissing the complaint.

From 1992 through 2004, PWC served as Apple Bank for Savings's, ("Apple" or "the Bank") auditor and tax preparer. In late 1999 or early 2000, Apple called Martin Rothbard ("Rothbard"), the manager of PWC's tax engagement team and asked Rothbard whether the Bank would incur negative tax consequences, under Section 593[1] of the Internal Revenue Code ("IRC"), if it entered into a stock redemption agreement with the estate of the Bank's deceased sole stockholder, Stanley Stahl ("the estate"). The estate's advisors sought to enter into a multi-year stock redemption arrangement with the Bank because the estate believed that it would be the most tax efficient way to pay its estate tax liability, however, the parties disagree about whether Rothbard was told about the timing or magnitude of the contemplated redemptions or that the estate qualified for beneficial tax treatment for distributions under section 303 of the IRC[2]. (Rothbard Dep.at 53-54, 65-66 [Hertzberg Ex. 23], Rawden Dep. At 69-70[Hertzberg Ex. 18], Hertzberg Aff, Ex. 15 Interrogatory Responses, 20 and 22)

1

Section 593 allowed thrift banks, providing certain requirements were met, to take a beneficial "bad debt" deduction from taxable income based on a percentage of taxable income rather than actual loan losses. Section 593 also provided that the annual bad debt deductions accumulated in a bad debt reserve and could be subject to "recapture"–i.e. be treated as taxable income–under certain circumstances.

2

Under IRC Section 303 the Estate would realize a significant tax saving because could pay taxes on the redemptions of the shares at capital gain rates as opposed to dividend or ordinary income rates.

After reviewing IRC Section 593 and IRC Section 302[3], Rothbard opined that the stock redemptions would be considered dividends and would not cause the Bank to incur negative income tax consequences as long as the redemptions did not exceed the bank's post-1951 earnings and profits ("E&P"). (Rothbard Dep., at 62-64)

Based on Rothbard's advice, in early 2000, the Bank began redeeming the estate's shares and the Bank redeemed additional shares in 2001, 2002, 2003 and 2004.

It is undisputed that, pursuant to annual engagement letters, PWC prepared the Bank's year end financial statements for 2000 through 2004 and that, pursuant to "tax preparation letters"(2000-2002) and a tax engagement letter for 2003, PWC prepared the Banks income taxes. It is also undisputed that the year end financial statements and the tax returns for each of these years expressly treated the estate's share redemptions as if they had not triggered any negative tax consequences.

However, in July, 2005, PWC learned that the Estate represented that it qualified, under Section 303 of the Internal Revenue Code, to treat the redemptions as sales or exchanges, rather than dividends under Section 302. Based on that information, PWC advised the Bank that if the estate qualified under Section 303, the redemptions had caused a "recapture" of Apple's bad debt reserves. PWC was now of the opinion that the stock redemptions had caused the Bank to incur income tax liability and that its year end financial statements for 2000 through 2004 and its income tax filings for 2000 through 2003 were

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3

Under IRC Section 302, pro rata distributions to shareholders, whether called a dividend, share repurchase or share redemption, are considered dividends for tax purposes, and only cause recapture under Section 593 if the amount exceeds the bank's post-1951 earnings and profits (E&P).

incorrect.[4] In August, 2005, the Bank and PWC had several conversations about how to remediate the problem and in November 29, 2005, at PWC's urging, the Bank filed amended tax returns for 2000, 2001, 2002 and 2003. As a result, the Bank was required to pay more than $12,000,000 in back taxes and interest. (Arnoff Exs. 58-61)

Moreover, PWC withdrew its audit reports concerning the Bank's 2003 and 2004 financial statements and the bank withdrew those financial statements. (Arnoff Ex. 47) In order to record the additional taxes owed as a result of the recapture, the Bank reported a one time reduction of retained earnings as of December 31, 2004 in the "Consolidated Statement of Changes of Stockholder's Equity" and discussed the matter in a footnote to its fiscal year 2005 financial statement. (Hertzberg Ex. 132)

This action followed. The complaint, which Apple filed in October, 2006, states two causes of action--the first for professional negligence in the preparation of the 2000 through 2003 tax returns and the 2000 through 2004 audits of the financial statements and a second cause of action for breach of contract in the preparation of those tax returns and audits.

In 2007, PWC moved to dismiss, as time barred, the Bank's malpractice claims for Rothbard's 1999 tax advice and the tax and audit work performed in 2000, 2001 and 2002. PWC's motion was granted as it related to the 2000, 2001 and 2002 financial statements because each of PWC's audits of the Bank's year end financial statements for those years

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4

In April 2005, the Bank informed PWC that, on a going forward basis, it would no longer be retaining PWC's services however, PWC did prepare the Bank's 2004 income tax filing.

was governed by a separate and discrete engagement letter and, therefore, the continuous treatment doctrine did not apply to toll the three year statute of limitations with respect to those financial statements.

However, the motion was denied with respect to Apple's tax claims on the ground that there was a question of fact regarding whether PWC provided continuous representation to the Bank regarding tax advice and tax preparation services.

PWC now moves for summary judgment dismissing the complaint on the grounds that Apples 2000 and 2001 tax claims are time barred; that Apple's claims for back taxes and interest must be dismissed as contrary to New York law and/or that they are barred by the terms of the engagement letters and that Apple cannot prove that PWC was the proximate cause of its injuries.

In support of the branch of the motion for summary judgment that seeks dismissal of the the Bank's malpractice claims that are based on the 2000 and 2001 tax filings, resulting from the allegedly negligent tax advice that PWC provided in 1999, PWC argues that, based on *Williamson v. PricewaterhouseCoopers*, 9 N.Y.3d 1 (2007), those claims are time barred by CPLR 214(6)'s three year statute of limitations because the parties did not have a mutual understanding that PWC's engagement was for continued representation regarding the estate's share redemptions, which was the specific subject matter of Rothbard's advice. PWC claims that in late 1999 or early 2000, the Bank had only two brief conversations with Rothbard regarding the tax consequences of the redemptions and that the Bank never again specifically consulted with PWC about the tax consequences of the redemptions. Moreover, PWC argues that the preparation of each tax filing (2000 and 2001) was governed by an individual engagement letter that did not include tax planning or tax advice services and that each engagement terminated when PWC delivered the tax return to the Bank.

PWC also contends that Apple never signed, and the parties never operated under, the so-called "2001 Recurring Engagement Letter" which provided that PWC would provide recurring tax consultation services to the bank.

In opposition, Apple argues that the "continuous representation" doctrine, which is an exception to the statute of limitations, applies in this case because, in essence, PWC served as Apple's tax department and tax advisor; that each year, from 2000 through 2003, PWC prepared the Bank's tax filings and each year it affirmatively applied its erroneous advice to the share redemption program. The Bank claims that in 2000, 2001 and thereafter, PWC's internal memoranda specifically note the need to get more information from the Bank regarding the redemptions and to analyze and properly assess the tax impact of the redemptions on the tax returns. The Bank also contends that, throughout this period, the parties contemplated that PWC would provide advice regarding special tax matters for an additional fee and that PWC did, in fact, bill the Bank for Rothbard's advice. (Arnoff Ex. 43) In addition, the bank contends that the parties operated under so-called 2001 "Recurring Engagement Letter" which includes a provision that PWC would provide recurring tax consulting services to the Bank. Moreover, the Bank claims that PWC's efforts to remediate the tax problem, after it was discovered, is further evidence of continuous representation. Alternatively, the Bank argues that there is a question of fact as to whether PWC provided continuous representation.

When a defendant moves to dismiss a cause of action on the ground that it is barred by the statute of limitations, "the defendant bears the burden of establishing such ground by *prima facie* proof that the time in which to sue has expired." (*Hertzberg & Sanchez, P.C. v. Friendship Dairies, Inc.*, 2007 WL 488141[N.Y. Sup. App. Term] In order to make a *prima facie* showing, the defendant must establish, *inter alia,* when the cause of action accrued. (*See, Swift v. New York Med. College,* 25 A.D.3d 686 [2nd Dept 2006]) The burden then shifts to the plaintiff to come forward with evidentiary facts establishing that the cause of action falls within an exception to the statute of limitations or to raise a question of fact as to whether an exception applies. (*Gravel v. Cicola,* 297 A.D.2d 620 [2nd Dept 2002])

CPLR 214(6) provides that professional malpractice claims, other than those alleging medical, dental or podiatric malpractice, must be commenced within three years of accrual. (CPLR 214(6); *Giarratano v. Silver,* 46 A.D.3d 1053, 1055 [3rd Dept 2007]citing *Ackerman v. Price Waterhouse,* 84 N.Y.2d 535, 541[1994]) The three year period begins to run and a malpractice cause of action against an accountant accrues "upon receipt of the accountant's work product." (*Ackerman v. Price Waterhouse,* 84 N.Y.2d at 541). This accrual date is used "even if the aggrieved party is then ignorant of the wrong or injury. " (*Ackerman v. Price Waterhouse,* 84 N.Y.2d at 541; *see also, Williamson v. PricewaterhouseCoopers, LLP* 9 N.Y.3d at **4 ["A claim accrues when the malpractice is committed, not when the client discovers it."])

The Bank commenced this action in October, 2006, and it is undisputed that all claims that accrued before June 23, 2004 are time barred unless the continuous representation doctrine applies.

Here, the Bank correctly argues that there are questions of fact about whether claims based on the1999 tax advice and resulting tax returns are timely under the "continuous representation"doctrine. (*Cuccolo v. Lipsky, Goodkin & Co.,* 826 F. Supp. 763, 768 [S.D.N.Y. 1993][*citing McDermott v. Torre,* 56 N.Y.2d 399, 406 [1982])

The continuous representation doctrine derives from the "continuous treatment" doctrine in medical malpractice cases and it:

> tolls the running of the statute of limitations on a claim arising from the rendition of professional services only so long as the defendant continues to advise the client in connection with the particular transaction which is the subject of the action and not merely during the continuation of a general professional relationship.

(*Booth v. Kriegel,* 36 A.D.3d 312 [1st Dept 2006][internal citations and quotations omitted]

"Determining whether a toll applies to a particular cause of action is generally a question of fact." (*Cohen v. Goodfriend,* 642 F.Supp. 95, 101 [E.D.N.Y. 1986]["the question of 'continuous treatment' is one primarily for the jury."][quoting *In re Investors Funding Corp.,* 523 F. Supp. 533, 547 [S.D.N.Y. 1980]; *Kletnieks v. Hertz,* 54 A.D.3d 660, 661 [2nd Dept 2008] In *Williamson v. PricewaterhouseCoopers*, 9 N.Y.3d at **7, the Court of Appeals recognized that "continuous representation" does not apply to a continuing general relationship between the parties. Rather, the Court held "that the nature and scope of the parties' retainer agreement [engagement] plays a key role in determining whether 'continuous representation' was contemplated by the parties." In *Williamson* the Court of Appeals found that the continuous representation doctrine did not apply because, for the years in question, the plaintiff entered into annual engagements with the defendant for the provision of separate and discrete audit services for plaintiff's year end financial statements and , "once defendant performed the services for a particular year, no further work as to that year was undertaken."

However, in *Fred Smith Plumbing & Heating Co. v. Christensen,* 233 A.D.2d 207, 209 [1st Dept. 1996], plaintiff commenced a malpractice action against its former accountant for issues related to executive compensation and Subchapter S status. Defendants sought dismiss certain claims based on the statute of limitations arguing that the services rendered and advice given were specific to each distinct tax year. In opposition, plaintiff submitted an affidavit stating that defendants regularly advised plaintiff with respect to, *inter alia*, tax issues, prepared its tax returns, discussed issues of executive compensation and performed other general accounting duties for plaintiff. In that case, the First Department held that, "at the very least, questions of fact exist as to whether the services rendered to plaintiff by defendant, . . ., constituted a continuous relationship . . . ."

In addition, in *Tayebi v. KPMG, LLP.,* 2008 WL 518149 [Sup. Ct., N.Y. County], I examined the parties' engagement letter and found that there were questions of fact regarding the continuing nature and scope of the parties relationship that precluded dismissal of plaintiff's claims as time barred. In that case, plaintiff retained KPMG in 1998 as his tax advisor. In 2000, KPMG marketed an allegedly fraudulent tax shelter to plaintiff and asserted that the Internal Revenue Service ("IRS") would allow a deduction for losses generated by the tax shelter. KPMG prepared plaintiff's 2000 taxes and it appears that KPMG continued to provide accounting services and tax advice to plaintiff through 2003. In 2004, the IRS notified plaintiff that the tax shelter deduction was invalid and plaintiff was required to pay substantial back taxes and interest. Plaintiff commenced an action against KPMG in 2007 and KPMG argued that the malpractice claims against it were time barred because the tax shelter transaction occurred in 2000. KPMG's motion to dismiss was denied because, in its engagement letter, KPMG contractually agreed to meet with Tayebi to "'discuss the U.S. federal income tax implications associated with participation in the [tax shelter transaction]'". This language demonstrated that KPMG did not intend to disassociate itself from plaintiff's tax shelter transaction and that the "intent of the engagement letter raises a significant factual issue, because the nature and scope of the Engagement Letter plays a key role in determining whether the parties contemplated continuous representation." (Id at *5 [*citing Williamson v. PricewaterhouseCoopers, LLP,* 9 N.Y.3d at 10])

In this case, PWC's letters to the Bank dated August 17, 1999; August 10, 2000 and July 16, 2001 (Hertz Aff., Exs. 24, 25 and 26), do not state that they are "engagement letters". Rather, they state that they are "estimates of professional fees for preparation of the Federal, state and local income tax returns . . . and review of the estimated tax declarations." (Hertz Aff., Exs. 24 and 25) Each letter contemplates that additional tax services may be needed, albeit for an increased fee:

> Please note that our fee does not include other special services such as responding to inquiries or tax examinations by the IRS or state and local taxing authorities, or for research or consultations related to tax planning ideas which may be identified during the tax return preparation process. We will provide you with a separate fee estimate for such services.

Contrary to PWC's assertion that each tax engagement was a discrete transaction, these estimate letters do not conclusively establish that the parties had a mutual understanding that Apple merely engaged PWC to prepare its 1999, 2000 and 2001 tax returns. The fact that the Bank may have had to pay an additional fee for "research or consultations regarding tax planning ideas" does not negate continuous representation. (See, *Tayebi v. KPMG,* 2008 WL 518149 at *5) Here, the letters acknowledgment that PWC would provide research and consultation related to tax planning ideas, raise questions as to the nature and extent of the parties relationship and whether the parties mutually understood that PWC's rendition of tax advisory and tax planning services was part of the continuing relationship between the parties.

Moreover, there is some evidence that the parties viewed their relationship as continuous. Although the tax preparation letters provide that Apple will pay a set fee for each year's tax return, Apple has produced evidence that it regularly sought PWC's advice and was billed accordingly. (Arnoff Aff., Ex. 41, 43, Rothbard at 106-107, 126-128, 131-132; Rawden 168-173, 175-176, 178-179) Apple also points to Rothbard's testimony stating that it was Rothbard's understanding that PWC had a recurring engagement to prepare tax returns for the bank. (Rothbard Dep. at 106-107)

In addition, the Bank has produced an unsigned October 29, 2001 "engagement letter to provide tax services" that states, "[f]rom time to time, [the Bank] may request [PWC] to provide tax services that will not be the subject of a separate engagement letter. This engagement letter and the attached **Terms of Engagement to Provide Tax Services** . . . summarize the scope of services we will perform . . . ." (emphasis in the original)(Arnoff Aff., Ex. 40) The list of services in the letter includes recurring tax consulting services (e.g. "advice, answers to questions and/or opinions on tax planning or reporting matters,". . . .")

and advice and assistance regarding matters involving the IRS or local taxing authorities. (Arnoff Aff., Ex. 40) Although PWC testified that the letter was sent to Apple, there is a factual dispute about whether the bank accepted the terms proposed in the letter and/or whether the parties operated under those terms.

Moreover, during the preparation of the 2000 and 2001 tax returns PWC requested documents from Apple concerning the share redemptions and internal PWC emails and memoranda demonstrate that PWC tax professionals discussed the need for more information from Apple so that they could properly assess the tax impact of the redemptions. (Arnoff Aff., Exs. 27, 28, 29, 30 and 31) These memoranda also raise questions regarding the continuous nature of the relationship between the Bank and PWC.

Turning to the recovery of back taxes and interest, PWC relies on *Alpert v. Shea Gould Climenko & Casey,* 160 A.D.2d 67, 71 (1st Dept 1990), and its progeny, for its assertion that Apple's demand for the recovery of back taxes and interest must be stricken because, as a matter of law, back taxes and interest are not recoverable under New York Law. In addition, PWC states that even if *Alpert* was not the rule in New York, the Bank cannot recover back taxes because it cannot demonstrate with reasonable certainty that PWC proximately caused its injuries because it cannot show that the taxes and interest could have been avoided and because the damages, if any, that Apple suffered were not reasonably forseeable.

In opposition, the Bank argues that both back taxes and interest are recoverable in accounting malpractice cases if the plaintiff can demonstrate that its tax liability is attributable to an act or omission by the accountant. It also contends that there are numerous questions of fact as to whether PWC proximately caused the Bank's injuries and whether the back taxes and interest it paid were a foreseeable result of Rothbard's allegedly erroneous advice and the negligent conduct of the tax and auditing professionals that worked on the Apple account.

In *Alpert v. Shea Gould Climenko & Casey,* 160 A.D.2d at 72, plaintiff's recovery of back taxes and interest was disallowed because plaintiff inevitably would have incurred the tax liability if it had not invested in the disallowed tax shelter. In that case, the court held that "[t]he recovery of consequential damages from a fraud is limited to that which is necessary to restore a party to the position it occupied before commission of the fraud. (*See also, Gaslow v. KPMG LLP,* 19 A.D.3d 264 [1st Dept 2005][claim for back taxes in accounting malpractice case dismissed where reimbursement of tax liability would put plaintiff in a better position if he had not made the tax shelter choice]; *Freschi v. Grand Coal Venture,* 767 F2d 1041 [2nd Cir. 1985][claim for interest denied where interest would confer a windfall on plaintiff]; *Thies v. Bryan Cave,* 2006 WL 2883815 [Sup. Ct. N.Y. County]). Thus, it appears that in determining whether back taxes and interest are recoverable in accounting malpractice actions, New York courts consider whether the plaintiff would have incurred the tax liability if they had not relied on the accountant's faulty advice. If the tax liability was inevitable, the recovery of taxes and interest is not permitted because it would create a windfall for the plaintiff. However, if the tax liability would have been avoided but for the erroneous advice, it appears that back taxes and interest would be recoverable in order to make the plaintiff whole (*See, e.g. Penner v. Hoffberg Oberfest Burger & Berger,* 303 A.D.2d 249 [1st Dept 2003][claims for back taxes and interest properly dismisses since tax liability was not attributable to act or omission of defendant][emphasis added]). In *Jamie Towers Housing Co., Inc. v. Lucas,* 296 A.D.2d 359 (1st Dept 2002), plaintiff, through no fault of its own, had to pay more than $400,000 in interest on delinquent taxes due to its managing agent's failure to timely pay certain taxes. In that case the court held that plaintiff should be permitted to prove its damages, if any, because the recovery of the interest would not create an impermissible windfall or put plaintiff in a better position then it was in prior to the agent's alleged misfeasance.

Here, PWC asserts that the estate had no recourse to pay its taxes other the redemption of Apple's shares because the estate tax it owed totaled $273 million while its assets were approximately $100 million (Hertzberg Aff. Ex. 47). Moreover, PWC states that in 2007, the Bank's tax advisor, questioned the business purpose in setting up a holding company to repurchase the shares from the estate. (Hertzberg Aff., Ex. 49, 50, 51)

On the other hand, Apple correctly argues that the evidence raises questions of fact about whether its tax liability could have been avoided if it had not relied on PWC's allegedly erroneous advice regarding the tax consequences of the stock redemptions. Apple contends that if Rothbard had not provided the allegedly incorrect opinion, it could have formed a holding company in 1999 or 2000 to avoid the recapture of the bad debt reserves. (Kelly Aff., paras. 12 and 13) It states that it did, in fact, form a holding company in 2007, and that it redeemed stock through that entity in 2008 without incurring the recapture of its remaining bad debt reserves. (Rawden Dep. at 397-399; Wolpert Dep. at 132-133) It also states that, in the alternative, if the holding company had not been viable, it simply could have declined to proceed with the redemptions because the estate had other options available to pay its estate taxes and it would not have entered into a transaction with the estate that would cause unnecessary tax liability for the bank (Wolpert Dep. at 43-47; Czaja Aff. paras 6 and 7)

There are also questions of fact about whether Rothbard and the other PWC tax professionals should have reasonably foreseen Apple's damages. Apple contends that the whole purpose of seeking Rothbard's advice regarding the redemptions, was to determine whether the Bank would be exposed to tax liability, and that a central issue in this case is whether Rothbard and the other tax professionals should have known that the Bank would be required to pay taxes and interest as a consequence of the allegedly erroneous advice (*Karamarios v. Bernstein Management,* 204 A.D.2d 139-140 [1st Dept 1994][foreseeability is generally a question of fact for the jury]). The fact that "defendant could not anticipate the . . . exact extent of the injuries, however, does not preclude liability . . . where the general risk and character of the injuries are foreseeable." (*Derdarian v. Felix Contracting Corp.*, 51 N.Y.2d 308, 312 [1980]) [5]

Regarding the contractual limitations of liability in the 2003 and 2004 tax engagement agreements and the audit engagement letters, PWC argues that under the terms

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PWC also contends that Apple should be equitably estopped from offering evidence about tax alternatives that were available to the estate because the Bank verified, in response the Third Interrogatories, that it had "no independent knowledge" of the estate's affairs and would not speculate to tell PWC what it or the estate would have done if it had been advised of the recapture issue. The Bank states that it declined to answer the interrogatories as improperly speculative and hypothetical because they asked what the Bank "would" have done, rather than what the Bank "could" have done. Here, estoppel is inappropriate because PWC had failed to demonstrate that it relied to its detriment on the Bank's failure to answer the interrogatory. (*See, e.g. Siger v. Rich,* 308 A.D.2d 235, 242 [1st Dept 2003]) of these letters[6], Apple's claims for damages, that exceed PWC's professional fees, must be dismissed because there is no proof that PWC was grossly negligent, or that it engaged in willful or fraudulent conduct. (Hertzberg Aff., Ex. 2, 3, 28 and 29)

In opposition, the Bank correctly contends that it is a question of fact whether PWC's actions rise to the level of gross negligence. (*International Nederlanden [U.S.] Capital Corp. v. Bankers Trust Co.*, 261 A.D.2d 117 [1st Dept 1999][*citing Food Pageant, Inc. v. Consol. Edison Co., Inc.*, 54 N.Y.2d 167, 173 (1981)]["Where the inquiry is to the existence or nonexistence of gross negligence . . . the question nevertheless remains a matter for jury determination."])

In the accounting malpractice context, liability for gross negligence may attach where there is a refusal to see the obvious and a gross failure to investigate the obvious. (*In re Allou Distributors, Inc.* 395 B.R. 246, 260 [Bankr. E.D.N.Y. 2008][*citing, State St. Trust Co. v. Ernst*, 278 N.Y. 104, 112 [1938]) In *Foothill Capital Corp. v. Grant Thornton, LLP*, 276 A.D.2d 437 (1st Dept 2000), the First Department found that gross negligence and recklessness allegations against an accountant had been sufficiently pled where the claim

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6 The 2003 and 2004 Tax Engagement and Audit Engagement Letters (Hertzberg Aff., Ex. 2, 3, 28 and 29) state:

> In no event, unless it has been finally determined that [PWC] was grossly negligent of acted willfully of fraudulently, shall [PWC] be liable to the client . . . whether a claim be in tort, contract or otherwise for any amount in excess of the total professional fee paid by you to us under this agreement for the particular service to which the claim relates. In no event shall [PWC] be liable for any special, consequential, indirect, exemplary, punitive, lost profits or similar damages, even if we have been apprised of the possibility thereof.

involved the accountants' failure to verify information on client's financial statements and failure to take additional auditing steps that it internally had deemed necessary. (*See also, DaPuzzo v. Reznick Fedder & Silverman,* 14 A.D.3d 302, 303 [1st Dept 2005][allegations including the accountants' blind acceptance of information without verifying it is sufficient to support a gross negligence claim.])

In this case there are questions of fact, including whether Rothbard knew that the Bank was inquiring about a multi-year plan to pay estate taxes and if so whether his failure to research and consider Section 303 of the IRC constituted gross negligence or recklessness; whether the PWC tax professionals who prepared the Banks' tax returns and documented the need to analyze the tax impact of the redemptions were grossly negligent in failing to obtain additional information about the redemptions. These questions cannot be resolved on the papers submitted and therefore, must be left for the jury to decide.

Moreover, dismissal of the Bank's claim for punitive damages is unwarranted at this juncture, because punitive damages may be recoverable for gross negligence or reckless conduct. (*Guariglia v. Price Chopper Operating Co., Inc.*, 38 A.D.3d 1043 [3rd Dept 2007]; *Glassman v. Wachovia Bank, N.A.*, 2007 WL 2582364 at *5 [Sup. Ct. N.Y. County])

Finally, turning to the 2003 and 2004 audits of the year end financial statements, in support of dismissal of the Bank's claims based on the 2003 and 2004 audits of the Bank's financial statements, PWC contends that there is no evidence that the alleged errors in the financial statements were material. It argues that in its engagement agreements it undertook to "perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement"(Hertzberg Affs., Ex. 2 and 3); that the alleged 5 percent overstatement of net income was immaterial to anyone who could have relied on the financial statements (Shamoon Dep. at 203, 205, Bush Dep. at 217) and that it cannot be held liable for an immaterial misstatement in the financial statement that was not identified in the audit. Alternatively, the Bank contends that even if the alleged errors were material, they did not cause any direct injury to the Bank (Hertzberg Aff. Ex. 15 and 16).

In opposition to dismissal, the Bank states that the materiality of PWC's alleged errors is not an element of its malpractice claim. It contends that its claims regarding the audits require it to demonstrate that PWC deviated from industry standards and that its damages were caused by PWC's alleged errors. Alternatively, it argues that if materiality is relevant, that, as a general rule, materiality is a question of fact. Apple also states that it withdrew its 2003 and 2004 financial statements and that there are questions of fact as to whether such withdrawal caused it to suffer injury to its goodwill and reputation (Shamoon Dep at 198-200, 202-207; Shamoon Aff. Para 4.

The Bank is correct that there are questions of fact as to whether PWC performed its audit in accordance with generally accepted standards in the industry, that is, whether PWC performed "the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement." (Hertzberg Aff., Exs. 2 and 3)

"Materiality is defined in the accounting literature as 'the magnitude of an omission or misstatement of accounting information that, in light of the surrounding circumstances, makes it probable that the judgment of a reasonable person would have been changed or influenced by the omission or misstatement. (*SEC v. Price Waterhouse,* 797 F. Supp. 1217, 1237 [S.D.N.Y. 1992] As a general rule, materiality is a question of fact. (*See, e.g., Brunetti* *v. Musallam,* 11 A.D.3d 280, 281 [1st Dept 2004])

Here, the Bank's president testified that being forced to pull the 2003 and 2004 financial statements was likely to have a negative impact on Apple's goodwill (Shamoon Dep. at 198-200, 202-207) Moreover, PWC's own witnesses testified that they contacted risk management because they considered the problem to be material. (O'Donnell Dep at 111-115; Lewis Dep at 50-52) The Bank also claims that withdrawal of the financial statements raises an inference of materiality.

On the other hand, PWC presents evidence to demonstrate that Apple did not suffer any negative consequences on account of the alleged misstatements. PWC cites to testimony by Apple's witnesses who were unable to identify any instances where, on account of the alleged misstatements, a customer declined to enter into a transaction with the Bank (Bush Dep. at 217); a depositor removed its funds from the Bank or a regulator took a negative action against the Bank (Shamoon Dep., at 203) or regulatory approval of a transaction or a business deal was lost. Herman Dep. at 188-189)

Moreover, there are questions of fact as to whether the alleged misstatements in the 2003 and 2004 audits caused Apple to suffer damage to its business reputation and goodwill.

Accordingly, it is ORDERED that PWC's motion for summary judgment dismissing the complaint is denied.

This decision constitutes the order of the court.

DATED 5/14/09

FILED
May 15 2009
NEW YORK
COUNTY CLERK'S OFFICE

J.S.C.

HON. BERNARD J. FRIED