Symbol Tech., Inc. v Deloitte & Touche, LLP
2008 NY Slip Op 31759(U)
June 16, 2008
Supreme Court, Suffolk County
Docket Number: 0033150/2006
Judge: Elizabeth H. Emerson

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SHORT FORM ORDER

INDEX
NO.: 33150-06

SUPREME COURT - STATE OF NEW YORK
COMMERCIAL DIVISION
TRIAL TERM, PART 44 SUFFOLK COUNTY

PRESENT: Hon. Elizabeth Hazlitt Emerson

MOTION DATE: 2-28-07
SUBMITTED: 10-10-07
MOTION NO.: 002-MG; CASE DISP

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SYMBOL TECHNOLOGIES, INC.,

Plaintiff,

-against-

DELOITTE & TOUCHE, LLP,

Defendant.

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Upon the following papers numbered 1 to 64 read on this motion to dismiss ; Notice of Motion and supporting papers 1-20 ; Notice of Cross Motion and supporting papers___; Answering Affidavits and supporting papers 21-35 ; Replying Affidavits and supporting papers 36-45 ; Other 46-57; 58; 59-60; 61; 62-64 ;it is,

ORDERED that this motion by the defendant for an order dismissing the complaint is granted.

The following facts have been taken from the amended complaint and the documentary evidence submitted by the parties:

In 2001, the plaintiff, Symbol Technologies, Inc., learned that more than a dozen members of its senior management were involved in a scheme to inflate its revenue and earnings through a variety of means, all of which were in violation of Generally Accepted Accounting Principles (hereinafter "GAAP"). Subsequent investigation revealed that, from 1998 through 2001, the plaintiff had overstated its revenues by a total of $234.2 million and its net earnings by a total of $324.7 million. Since stock options and bonuses were based on the plaintiff's performance, the plaintiff's senior management received more than $100 million in compensation to which they would not otherwise have been entitled. The plaintiff was the subject of investigations by the U.S. Attorney for the Eastern District of New York and the Securities and Exchange Commission (hereinafter "SEC"). The federal criminal investigation was resolved by a non-prosecution agreement in which the plaintiff acknowledged that, as a result of the conduct of certain officers,

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executives, and employees, Symbol had violated federal criminal law in connection with its accounting practices and that it had filed and caused to be filed materially false and misleading financial statements and other documents with the SEC. More than a dozen members of the plaintiff's senior management, including the President and Chief Executive Officer[1], Senior Vice President of Finance and Chief Financial Officer, Senior Vice President and General Manager of Worldwide Sales, Senior Vice President of Finance, Senior Vice President of Corporate Development, Chief Accounting Officer, Vice President of Finance, Senior Director of Finance, Director of Finance, and Director of Sales Operations pleaded guilty to or were indicted for securities fraud in connection with their employment at Symbol Technologies. Moreover, the plaintiff's shareholders commenced a federal class action lawsuit against Symbol, which was settled for $139 million.

The defendant, Deloitte & Touche, LLP, was the plaintiff's independent auditor for the period in question, i.e., 1998 through 2001. The defendant reviewed and audited the plaintiff's quarterly and year-end financial statements pursuant to separate engagement letters dated November 10, 1998; November 4, 1999; November 15, 2000; and November 19, 2001. The engagement letters provided that the audits would be conducted in accordance with Generally Accepted Auditing Standards. The defendant issued clean, unqualified audit opinions for the years 1998 through 2000. In 2001, the plaintiff learned that the SEC had received an anonymous letter criticizing its accounting practices, specifically its revenue recognition practices. The plaintiff advised the defendant of the allegations made to the SEC and hired the law firm of Clifford Chance Rogers & Wells (hereinafter "Clifford Chance") and the accounting firm KPMG to conduct an investigation. In addition, the defendant re-reviewed the prior year's audit. On July 25, 2001, the defendant reported to the plaintiff's Audit Committee that it had performed a significant amount of audit work that had not been performed in past quarterly reviews and that the revenue recognition practices complied with GAAP and the SEC's requirements. The Clifford Chance-KPMG investigation, however, raised a number of red flags about which the plaintiff sought the defendant's advice. On October 18, 2001, the defendant advised the plaintiff's Audit Committee that, after performing additional audit work, none of KPMG's findings were confirmed. The defendant subsequently issued a clean, unqualified audit opinion for 2001.

It was later determined that the initial investigation by Clifford Chance and KPMG had been undermined by the actions of Michael DeGenarro, the plaintiff's Senior Vice President of Finance, who had concealed documents from the investigators. DeGenarro joined Symbol Technologies in 2000. He had previously been employed by the defendant, where he was an audit partner on the Symbol Technologies account. As the plaintiff's Senior Vice President of Finance, he was Symbol's liaison with the defendant during the review and audit process. He was fired in September 2002 and indicted in June 2004 on federal conspiracy and securities fraud charges in connection with his misconduct at Symbol Technologies.

In early 2002, the SEC advised the plaintiff that it had additional concerns and that

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[1] The President and Chief Executive Officer also served on Symbol's Board of Directors from 1995 to 2002.

the plaintiff needed to inquire further into the accuracy of its Deloitte-audited financial statements. The plaintiff hired the law firm of Swidler Berlin Shereff Friedman, LLP (hereinafter "Swidler Berlin"), and a new forensic audit team from KPMG to conduct another investigation. The second investigation revealed numerous accounting irregularities related to revenue recognition, the improper use of reserves and restructuring charges, and other non-GAAP accounting practices intended to inflate revenues and earnings. As a result of the second investigation by Swidler Berlin and KPMG, the plaintiff was forced to restate its financial results for the years 1998 through 2001. After interviewing other accounting firms, the plaintiff hired the defendant to conduct a re-examination and re-audit of its 1998-2001 financial statements. The plaintiff hired the defendant because it believed that the other accounting firms were unwilling to step in before a new, unqualified audit opinion was rendered and because of the New York Stock Exchange's position regarding its financial statements. The Stock Exchange had threatened to delist Symbol if the defendant quit, was fired, or could not render a timely auditing opinion of the plaintiff's 2002 financial statements, which had been delayed. Thus, in addition to hiring the defendant for the restatement, the plaintiff hired the defendant to audit its consolidated financial statements for the year ending December 31, 2002, and to perform a review of its interim financial information for each of the quarters in the years ending December 31, 2002 and 2001. The restatement of the plaintiff's 1998-2001 financial statements was completed and filed on December 30, 2003. It adjusted virtually every line item on the 1998-2001 financial statements. The entire process cost the plaintiff approximately $30 million. In April 2004, the plaintiff terminated the defendant's services and retained another accounting firm to take over the audit responsibilities.

The parties agree that this action is deemed filed as of November 11, 2005. The complaint, as amended, contains four causes of action against Deloitte & Touche to recover damages for professional negligence (malpractice), breach of contract, fraud, and negligent misrepresentation. The plaintiff alleges that Deloitte's negligent and reckless neglect of its duties and its failure to competently perform the audits for which it was paid, cost Symbol tens of millions of dollars in accounting and legal fees, lost sales, bonus payments, and stock options. Instead of filing an answer, the defendant has moved to dismiss the complaint as time-barred and as barred by the doctrine of in pari delicto.

The Statute of Limitations

A cause of action charging that a professional failed to perform services with due care and in accordance with the recognized and accepted practices of the profession is governed by the three-year statute of limitations applicable to negligence actions (see, CPLR 214[6]). A malpractice action sounds in tort. Therefore, absent fraud, it accrues when an injury occurs, even if the aggrieved party is then ignorant of the wrong or injury (*see*, **Ackerman v Price Waterhouse**, 84 NY2d 535, 541). In the context of a malpractice action against an accountant, the claim accrues upon the client's receipt of the accountant's work product since that is the point when a client reasonably relies on the accountant's skill and advice, when all of the facts necessary to the cause of action have occurred, and when an injured party can obtain relief in court (**Id**. at 541).

The plaintiff contends that the defendant issued its last negligent opinion of Symbol's 1998 financial data on February 20, 2001, and that the defendant issued its last negligent opinions of Symbol's 1999, 2000, and 2001 financial data on March 26, 2002. The parties agree that this action is deemed filed as of November 11, 2005. Thus, absent application of the continuous representation doctrine, the plaintiff's malpractice claims are time-barred.

The continuous representation doctrine derives from the continuous treatment doctrine in medical malpractice cases and 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 that is the subject of the action and not merely during the continuation of a general professional relationship (*see*, **Booth v Kriegel**, 36 AD3d 312, 314). Continuous representation requires that the parties possess a mutual understanding of the need for further representation on the specific subject matter underlying the malpractice claim (*see*, **McCoy v Feinman**, 99 NY2d 295, 306; *see also*, **Zorn v Gilbert** 8 NY3d 933, 934). In the accounting context, the mere recurrence of professional services does not constitute continuous representation (*see*, **Booth v Kriegel**, *supra* at 314). In **Williamson v PricewaterhouseCoopers LLP** (9 NY3d 1, 10), the Court of Appeals held that continuous representation does not apply to a continuing general relationship between the parties. Rather, the Court held, "[T]he nature and scope of the parties' retainer agreement (engagement) play a key role in determining whether continuous representation was contemplated by the parties." The Court of Appeals concluded that the continuous representation doctrine did not apply in that case because, for the years in question, the plaintiff had entered into annual engagements with the defendant for the provision of separate and discrete audit services for the plaintiff's year-end financial statements and, once the defendant had performed the services for a particular year, no further work as to that year was undertaken (**Id**. at 10-11).

Here, each of the defendant's audits of the plaintiff's year-end financial statements for the years 1998, 1999, 2000, and 2001 was governed by a separate and discrete engagement letter. Each letter was signed by both parties and indicated that it was for that particular year. Moreover, each letter contained the following language:

> Any request by [Symbol Technologies] to reissue our report...will be considered based on the facts and circumstances existing at the time of such request. The estimated fees outlined herein do not include any services that would need to be performed in connection with any such request; fees for such services (and their scope) would be subject to our mutual agreement at such time **and would be described in a separate engagement letter** (emphasis added).

In view of the foregoing, the court finds that the parties did not contemplate any further audit work as a result of the specific engagements for the years in question (*see*, **Apple Bank for Savings v PricewaterhouseCoopers LLP**, 18 Misc 3d 1137[A], *3). The court also finds that the additional work undertaken by the defendant to re-examine and re-audit the plaintiff's 1998-2001 financial statements was not a continuation of the prior engagements, but a separate and discrete engagement. The defendant was under no obligation to perform such work. It was not required or even contemplated by the prior engagement letters. In fact, those letters specifically provided that any re-issuance of the defendant's audit reports would be subject to the parties' mutual agreement and a separate engagement letter. The plaintiff hired the defendant to perform the restatement only after it had interviewed other accounting firms for the job and for reasons unrelated to the prior engagements, i.e., because it believed that the other accounting firms would not step in and because of the New York Stock Exchange's position regarding its financial statements. The plaintiff does not allege that the restatement, which was based on entirely new financial data, was negligently performed. Moreover, the fact that the defendant provided audit-related services to the plaintiff in 2002 and 2003 merely indicates a continuation of their professional relationship and is insufficient to raise an issue of fact regarding the applicability of the continuous representation doctrine (*see*, **Serino v Lipper**, 47 AD3d 70, 76). Under these circumstances, the court finds that the plaintiff has not met its burden of demonstrating that the continuous representation doctrine applies (*see*, **CPL Leasing Co. v Nessen**, 12 AD3d 226). Accordingly, the court finds that the plaintiff's malpractice claim is time-barred.

A breach-of-contract claim premised on an attorney's failure to exercise due care or to abide by general professional standards is redundant of the malpractice claim (*see*, **Sage Realty Corp. v Proskauer Rose**, 251 AD2d 35, 38). The plaintiff's breach-of-contract claim is nothing more than a rephrasing of its malpractice claim in the language of breach of contract. It is covered by the three-year statute of limitations found in CPLR 214 (6), which applies regardless of whether the underlying theory is based in contract or tort (*see*, **Mitschele v Schultz**, 36 AD3d 249, 252; *see also*, **Giarratano v Silver**, 46 AD3d 1053, 1057). Accordingly, the plaintiff's breach-of-contract claim is also time-barred.

The plaintiff's fraud claim does not state a cause of action separate and distinct from the malpractice cause of action. A separate cause of action for fraud may be established when exposure to liability is not based on errors of professional judgment, but is predicated on proof of the commission of an intentional tort (*see*, **Simcuski v Saeli**, 44 NY2d 442, 452-453). A defendant's concealment or failure to disclose his own malpractice, without more, does not give rise to a cause of action for fraud or deceit separate and distinct from the customary malpractice action (*see*, **Mitschele v Schultz**, *supra* at 254; **LaBrake v Enzien**, 167 AD2d 709, 711). Moreover, the damages sustained by virtue of a fraud must be different from or additional to those sustained by virtue of any malpractice (*see*, **LaBrake v Enzien**, *supra* at 711-712). Here, the defendant's alleged fraud is simply the failure to disclose to the plaintiff's Board of Directors and Audit Committee the malpractice underlying the 2001 audit report, and the purported fraud damages are the same as those generated by the alleged malpractice. The plaintiff merely alleges that the defendant's fraud injured Symbol "as described previously." Accordingly, the plaintiff's fraud claim cannot be maintained.

Like the fraud claim, the plaintiff's negligent misrepresentation claim arises from the same facts as the malpractice claim and is duplicative of that cause of action (*see*, **Mecca v Shang**, 258 AD2d 569, 570). Moreover, the plaintiff does not allege any damages distinct from those generated by the alleged malpractice. Accordingly, the plaintiff's negligent misrepresentation claim must fail.

<u>In Pari Delicto</u>

In pari delicto is a state law equitable defense analogous to unclean hands and is rooted in the common-law notion that a plaintiff's recovery may be barred by his own wrongful conduct. It is based on the idea that, when parties are equally at fault, the defending party is in the stronger position. It is not enough that both parties are at fault, or in delicto, they must be equally at fault, or in pari delicto. In other words, in pari delicto refers to the plaintiff's participation in the same wrongdoing as the defendant. The doctrine is based on the premises that (I) courts should not mediate disputes between wrongdoers and (ii) denying judicial relief to wrongdoers deters illegal conduct (*see*, **In re Food Management Group v Rattet**, 380 BR 677, 693-694 [citations omitted]).

There is a very narrow exception to the in pari delicto doctrine. Under New York law, the adverse interest exception rebuts the usual presumption that the acts and knowledge of an agent acting within the scope of his employment are imputed to the principal. Thus, management misconduct will not be imputed to the corporation if the officer acted entirely in his own interests and adversely to the interests of the corporation. The theory being that, when an agent, though ostensibly acting in the business of the principal, is really committing a fraud for his own benefit, he is acting outside of the scope of his agency. It would, therefore, be unjust to charge the principal with knowledge of the fraud. The adverse interest exception only applies when the agent has totally abandoned the principal's interests. It does not apply simply because the agent has a conflict of interest or does not act primarily for his principal (**Id.** at 696; *see also*, **Center v Hampton Affiliates**, 66 NY2d 782, 784-785; **In re Alphastar Ins. Group Ltd. v Arthur Andersen LLP**, 383 BR 231, 272-273).

The adverse interest exception is subject to the sole actor rule, which renders the exception inapplicable when the wrongdoing agent is the corporation's sole shareholder or when all of the corporation's management participates in the wrongdoing. Under the sole actor rule, the agent's knowledge is imputed to the principal notwithstanding the agent's self-dealing because the party who should have been informed of the wrongdoing was the agent itself, albeit in his capacity as principal (**In re Food Management Group v Rattet**, *supra* at 696-697; **In re Alphastar Ins. Group Ltd. v Arthur Andersen LLP**, *supra* at 273). The most obvious applicability of the sole actor rule is when a single person owns and manages a corporation. However, in a larger company, where there may be others in management who were innocent of the fraud, the sole actor rule is the second part of a larger analysis. When only some of a corporation's owners were involved in a fraud in their role as managers, courts may consider whether those insiders who were innocent and unaware of the misconduct had sufficient authority to stop the fraud. When the innocent insiders lacked authority to stop the fraud, the sole actor exception to the adverse interest exception applies. Imputation is, thus, proper because all of the relevant shareholders and decision makers were involved in the fraud. However, when the innocent insiders possessed authority to stop the fraud, the sole actor rule does not apply because the culpable agents who had totally abandoned the interests of the principal and were acting outside the scope of their agency were not identical to the principal (*see*, **Morgado Family Partners v Lipper**, 6 Misc 3d 1014[A], *4; *affd* 19 AD3d 262).

Contrary to the plaintiff's contentions the court finds that the doctrine of in pari delicto applies to the facts of this case. The approval and oversight of financial statements is an ordinary function of management that is done on the company's behalf, which is typically enough

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to attribute management's actions to the company itself (*see*, **Baena v KPMG, LLP**, 453 F3d 1, 7). The plaintiff's own version of events establishes that Symbol's senior management were the primary wrongdoers. Symbol's President and Chief Executive Officer, Senior Vice President of Finance and Chief Financial Officer, Senior Vice President and General Manager of Worldwide Sales, Senior Vice President of Finance, Senior Vice President of Corporate Development, Chief Accounting Officer, Vice President of Finance, Senior Director of Finance, Director of Finance, and Director of Sales Operations, were all knowing parties to the fraudulent financial statements. Michael DeGenarro, who was Symbol's Senior Vice President of Finance from 2000 to 2002, acted as Symbol's liaison with the defendant during the review and audit process and concealed documents from the KPMG investigators. More than a dozen members of the plaintiff's senior management, including De Genarro and the aforementioned officers, pleaded guilty to or were indicted for securities fraud in connection with their employment at Symbol Technologies. Moreover, the plaintiff acknowledged in its non-prosecution agreement with the federal government that, as a result of the conduct of certain officers, executives, and employees, Symbol had violated federal criminal law in connection with its accounting practices and that it had filed and caused to be filed materially false and misleading financial statements and other documents with the SEC.

The plaintiff argues that the misconduct of its agents cannot be imputed to Symbol under the adverse interest exception to the in pari delicto doctrine. Imputation may be avoided when the wrongdoing is done primarily for the personal benefit of the corporate officer and is adverse to the interests of the company. For example, if a salesman uses a company car in a bank robbery, the company is not normally liable (**Id.** at 7). However, the present case is not of that kind. A fraud by top management to overstate earnings, and so facilitate stock sales or acquisitions, is not in the long term interests of the company. Like price-fixing, it profits the company in the first instance, and the company is still civilly and criminally liable. It does not matter that the implicated managers also may have seen benefits to themselves. That alone does not make their interests adverse (**Id.** at 7-8). Accordingly, the court finds that the facts do not warrant application of the adverse interest exception.

In view of the foregoing, there is no need to reach the far less well-established notion that in pari delicto should not apply when innocent decision makers could have prevented the harm. The innocent decision maker or innocent insider rule has been adopted by only a few trial courts in the Second Circuit (**Id.** at 8). It has not yet been adopted by the New York State courts (*see*, **Morgado Family Partners v Lipper**, *supra* at *5; *see also*, **In re Alphastar Ins. Group Ltd. v Arthur Andersen LLP**, *supra* at 273), and some courts have refused to recognize it in order to encourage management to choose its agents carefully and to police them. Imputation of agent misconduct to innocent management accomplishes that goal (*see*, **Morgado Family Partners v Lipper**, *supra* at *5; *see also*, **Baena v KPMG, LLP**, *supra* at 8). Accordingly, the court declines to consider it.

Conclusion

The defendant's motion is granted, and the complaint is dismissed.

HON. ELIZABETH HAZLITT EMERSON

DATED: June 16, 2008

J. S.C.