

Serino v Lipper

2013 NY Slip Op 30871(U)

April 24, 2013

Supreme Court, Westchester County

Docket Number: 604396/2002

Judge: Shirley Werner Kornreich

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SUPREME COURT OF THE STATE OF NEW YORK NEW YORK COUNTY

PRESENT: JUSTICE SHIRLEY WERNER KORNREICH
Justice

PART 54

— Index Number : 604396/2002
SERANO, MATTHEW
vs.
LIPPER, KENNETH
SEQUENCE NUMBER : 026
DISMISS ACTION

INDEX NO. _____
MOTION DATE 3/5/13
MOTION SEQ. NO. _____

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

Notice of Motion/Order to Show Cause — Affidavits — Exhibits _____ | No(s). _____
Answering Affidavits — Exhibits _____ | No(s). _____
Replying Affidavits _____ | No(s). _____

Upon the foregoing papers, it is ordered that this motion is

**MOTION IS DECIDED IN ACCORDANCE
WITH ACCOMPANYING MEMORANDUM
DECISION AND ORDER.**

FILED

APR 25 2013

NEW YORK
COUNTY CLERK'S OFFICE

[Signature]
SHIRLEY WERNER KORNREICH
J.S.C. J.S.C.

Dated: 4/24/13

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

1. CHECK ONE: CASE DISPOSED NON-FINAL DISPOSITION
2. CHECK AS APPROPRIATE: MOTION IS: GRANTED DENIED GRANTED IN PART OTHER
3. CHECK IF APPROPRIATE: SETTLE ORDER SUBMIT ORDER
- DO NOT POST FIDUCIARY APPOINTMENT REFERENCE
- Cross-motion denied

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 54

-----X
MATTHEW SERINO and LUCILLE SERINO,
individually and on behalf of all others similarly
situated.

Index No.: 604396/2002

DECISION & ORDER

Plaintiffs,

-against-

KENNETH LIPPER, LIPPER HOLDINGS, LLC,
PRICEWATERHOUSECOOPERS LLP, LIPPER
& COMPANY, INC., ABRAHAM BIDERMAN,
LAWRENCE BLOCK, EDWARD STRAFACI, and
MICHAEL VISOVSKY,

Defendants.

-----X
SHIRLEY WERNER KORNREICH, J.:

FILED

APR 25 2013

NEW YORK
COUNTY CLERK'S OFFICE

Defendant PricewaterhouseCoopers LLP (PwC) moves for summary judgment, pursuant to CPLR 3212, for dismissal of the cross-claims of defendants Kenneth Lipper (Mr. Lipper) and Lipper & Company, Inc. (Lipper Inc.) (collectively, the Lipper Defendants). Mr. Lipper cross-moves for partial summary judgment against PwC. PwC's motion is granted and Mr. Lipper's cross-motion is denied for the reasons that follow.

I. Procedural History & Factual Background

This case was commenced in 2002 as a putative class action by former investors in the hedge funds operated by defendants (known as the Lipper Convertibles Funds; hereinafter, the Funds). In short, former defendant Edward Strafaci committed criminal securities fraud (for which he served a six year prison sentence) by grossly inflating the value of the Funds' securities, which led to the Funds' collapse. On February 13, 2004, a judgment was entered against former defendant Lipper Holdings, LLC (Holdings), the Funds' general partner, for approximately \$91 million. At all relevant times, Lipper Inc. was the general partner or

managing member of the Funds' general partner (which was Lipper L.P. from 1987 to 1997, and Holdings since 1997).

The court assumes familiarity with the order of the Appellate Division, First Department, dated November 20, 2007, which sets forth the factual background and complex procedural history of this action. *See Serino v Lipper*, 47 AD3d 70, 72-75 (1st Dept 2007). The only portion of this litigation that remains to be adjudicated is the Lipper Defendants' cross-claims against PwC for (1) fraud; (2) negligence/malpractice; (3) negligent misrepresentation; (4) breach of contract; and (5) breach of fiduciary duty. For the reasons discussed herein, the Lipper Defendants cannot maintain these claims against PwC.

II. Discussion

It is well established that summary judgment may be granted only when it is clear that no triable issue of fact exists. *Alvarez v Prospect Hosp.*, 68 NY2d 320, 325 (1986). The burden is upon the moving party to make a *prima facie* showing of entitlement to summary judgment as a matter of law. *Zuckerman v City of New York*, 49 NY2d 557, 562 (1980); *Friends of Animals, Inc. v Associated Fur Mfrs., Inc.*, 46 NY2d 1065, 1067 (1979). A failure to make such a *prima facie* showing requires a denial of the motion, regardless of the sufficiency of the opposing papers. *Ayotte v Gervasio*, 81 NY2d 1062, 1063 (1993). If a *prima facie* showing has been made, the burden shifts to the opposing party to produce evidentiary proof sufficient to establish the existence of material issues of fact. *Alvarez*, 68 NY2d at 324; *Zuckerman*, 49 NY2d at 562. The papers submitted in support of and in opposition to a summary judgment motion are examined in the light most favorable to the party opposing the motion. *Martin v Briggs*, 235 AD2d 192, 196 (1st Dept 1997). Mere conclusions, unsubstantiated allegations, or expressions

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of hope are insufficient to defeat a summary judgment motion. *Zuckerman*, 49 NY2d at 562. Upon the completion of the court's examination of all the documents submitted in connection with a summary judgment motion, the motion must be denied if there is any doubt as to the existence of a triable issue of fact. *Rotuba Extruders, Inc. v Ceppos*, 46 NY2d 223, 231 (1978).

A. Mr. Lipper's Claims

The parties disagree over the meaning of footnote 8 in *Serino*, which sets forth:

While Mr. Lipper's negligence and malpractice claims should be dismissed on statute of limitations grounds, the portion of the order dismissing Mr. Lipper's negligence/malpractice claims for lack of standing was error. We find that Mr. Lipper's allegations sufficiently established a relationship between him and PwC that approached privity such that he had standing to sue. Thus Mr. Lipper repeatedly directed Stoler to inform him of any issue or problem PwC had discovered relating to any fund it had audited because he was relying on PwC and its audit reports not only for running Convertibles but also in making personal financial decisions, that "almost all of [his] net worth and a significant portion of his family's assets were invested in" Convertibles and the Managing Entities, and that he would suffer substantial losses "both personally and financially" in the event of any lapses. In addition to PwC's audit work for Convertibles, PwC prepared Mr. Lipper's personal tax returns and balance sheets reflecting his net worth as well as a valuation of the Managing Entities, which necessarily required an intimate familiarity with Mr. Lipper's personal finances, including the extent of his interest in Convertibles.

Serino, 47 AD3d at 77, n.8 (internal citation omitted).

This passage is contained in a footnote because it is dicta. The purpose of the footnote was to comment that the trial court judge erred in holding that Mr. Lipper did not have the near-privity relationship required to maintain a claim for malpractice. However, the error was irrelevant since the malpractice claim was held to be time-barred. Nonetheless, Mr. Lipper contends that, in this passage, the Appellate Division held that he may maintain his negligence and malpractice claims against PwC.

Mr. Lipper is wrong because he conflates the concept of near-privity and standing to maintain a derivative claim. “New York courts impose a strict privity requirement to claims of [malpractice]: an [accountant] is not liable to a third party for negligence in performing services on behalf of his client.” *Lavanant v General Acc. Ins. Co. of America*, 164 AD2d 73, 81 (1st Dept 1990). However, “[w]hile privity of contract is generally necessary to state a cause of action for [malpractice], liability is extended to third parties, not in privity, for harm caused by professional negligence in the presence of fraud, collusion, malicious acts or other special circumstances.” *Good Old Days Tavern, Inc. v Zwirn*, 259 AD2d 300 (1st Dept 1999).

In *Serino*, the Appellate Division held that Mr. Lipper’s near-privity relationship with PwC would have allowed him to maintain a malpractice claim if such claim was not time-barred. However, the Appellate Division did not address the distinct standing inquiry on this motion – namely, whether Mr. Lipper’s claims against PwC are direct or derivative.

The Appellate Division, First Department, has adopted Delaware’s *Tooley* standard to determine if a claim is direct or derivative. *See Yudell v Gilbert*, 99 AD3d 108, 113-14 (1st Dept 2012). Under *Tooley*, the question of whether a claim is direct or derivative “must turn *solely* on the following questions: (1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders, individually)?” *Tooley v Donaldson, Lufkin & Jenrette, Inc.*, 845 A2d 1031, 1033 (Del 2004) (emphasis in original).

The vast majority of the damages that Mr. Lipper seeks from PwC is the money he lost when the Funds collapsed. This is a derivative claim. *See O’Neill v Warburg, Pincus & Co.*, 39 AD3d 281 (1st Dept 2007) (“[a] claim for diminution of the value of stock holdings is a

derivative cause of action belonging to that corporation and not to plaintiffs individually”). The existence of a near-privity relationship between Mr. Lipper and PwC does not alter the standing inquiry. The damages suffered by Mr. Lipper are identical to those suffered by the other investors. Ergo, he lacks standing to maintain this claim because he did not plead demand futility. *See Marx v Akers*, 88 NY2d 189, 198 (1996).

Nevertheless, Mr. Lipper avers that he suffered individualized damages because: (1) PwC’s fraud destroyed his career; and (2) he paid over \$6 million in gift taxes when he transferred a portion of his interest in the Funds to his children.

Mr. Lipper cannot maintain a claim against PwC for his lost earnings because they are impermissibly speculative. Mr. Lipper contends that he is entitled to recover a multimillion dollar annual salary that he would have earned if his reputation in the financial industry was not tarnished due to PwC’s actions. At this juncture, the court notes that it will not address the issue of whether Mr. Lipper had actual or constructive knowledge of Strafaci’s fraud that would preclude him from claiming reasonable reliance on PwC.¹ This issue is mooted by Mr. Lipper’s lack of standing and the *in pari delicto* doctrine’s applicability to Lipper Inc.’s claims (discussed *infra*, part II.B). That being said, the legal determination of whether Mr. Lipper ought to have known about the fraud has no bearing on whether Mr. Lipper’s peers in the financial industry would ever trust him to hold an executive position after such a high profile fraud occurred on his watch. The determination of how the financial industry allocated blame for the fraud in Mr. Lipper’s company and how such blame impacted Mr. Lipper’s earnings is far too speculative of an inquiry to be adjudicated by this court. Consequently, Mr. Lipper cannot hold PwC liable for his lost earnings.

¹ Though, in keeping with the theme of footnoting dicta, the court notes that it would have held that Mr. Lipper cannot maintain his fraud claim on this ground.

Finally, Mr. Lipper cannot maintain a claim against PwC for the gift taxes that he paid because he failed to seek a refund or credit from the IRS. Indeed, the statute of limitations on Mr. Lipper's claim for recoupment of gift taxes has long passed. See *United States v Dalm*, 494 US 596, 602 (1990). Mr. Lipper has known about Strafaci's fraud for over a decade. His failure to seek recoupment from the IRS precludes his assertion of this time-barred tax claim against PwC. In sum, the court grants summary judgment to PwC on Mr. Lipper's cross-claims and such claims are dismissed.

B. Lipper Inc.'s Claims

It is undisputed that Strafaci committed fraud in connection with his employment at the Funds. Thus, Lipper Inc., Holdings, and the Funds are precluded from asserting claims against PwC under the doctrine of *in pari delicto*, "which mandates that the courts will not intercede to resolve a dispute between two wrongdoers." *Kirschner v KPMG LLP*, 15 NY3d 446, 464 (2010). However, Lipper Inc. argues that *in pari delicto* does not apply to its claims for two reasons: (1) Strafaci's fraud cannot be imputed to Lipper Inc.; and (2) *in pari delicto* does not apply because its claims are direct, not derivative of Holdings' or the Funds' claims. Lipper Inc. is wrong on both counts.

"Agency law presumes imputation even where the agent acts less than admirably, exhibits poor business judgment, or commits fraud." *Kirschner*, 15 NY3d at 465. Imputation "is a legal presumption that governs in every case, except where the corporation is actually the agent's intended victim." *Id.* at 466. This exception is called the "adverse interest exception," and applies only where the agent has "*totally abandoned* his principal's interests and [is] acting entirely for his own or another's purposes. It cannot be invoked merely because he has a conflict

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of interest or because he is not acting primarily for his principal.” *Id.* (emphasis in original; citation and quotation marks omitted).

Here, Strafaci’s motive to commit fraud was straightforward. Strafaci’s compensation, like most fund managers, was based on the Funds’ performance. By overstating the value of the Funds’ securities, Strafaci’s compensation increased proportionally. However, this type of fraud does not fall within the adverse interest exception because “the scheme that benefitted [Strafaci]” did not “[operate] at the corporation’s expense.” *Kirschner*, 15 NY3d at 467-68, citing *Baena v KPMG LLP*, 453 F3d 1, 7 (1st Cir 2006) (“A fraud by top management to overstate earnings . . . is not in the long-term interest of the company; but, like price-fixing, it profits the company in the first instance”). Therefore, the adverse interest exception does not apply because Lipper Inc., Holdings, and the Funds (and indeed, Mr. Lipper) benefited from the fraud.

Despite this analysis, Lipper Inc. maintains that Strafaci’s knowledge can only be imputed to Holdings and the Funds, not Lipper Inc., because its claims against PwC are direct (and not derivative of Holdings’ and the Funds’ claims). Lipper Inc. suggests that, as a general partner, it may assert its claims directly. *See* Lipper Inc. Mem., p.15, *accord HB General Corp. v Manchester Partners, L.P.*, 95 F3d 1185, 1194 (3d Cir 1996). This argument is flawed.

Lipper Inc. is saddled with the Funds’ and Holdings’ imputed knowledge of Strafaci’s fraud because, as a general partner asserting a direct claim, it is stepping into the partnership’s shoes. Since the doctrine of *in pari delicto* precludes Holdings and the Funds from maintaining a fraud claim against PwC, Lipper Inc. is likewise barred from asserting such claim on their behalf. Alternatively, if Lipper Inc.’s claims were derivative, it would also suffer from the same standing problem that dooms Mr. Lipper’s claims. Either way, Lipper Inc. cannot maintain its claims

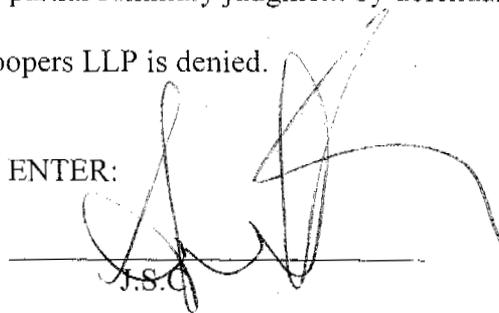
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against PwC. Therefore, the court grants summary judgment to PwC on Lipper Inc.'s cross-claims and the claims are dismissed. Accordingly, it is

ORDERED that the motion for summary judgment by defendant PricewaterhouseCoopers LLP is granted against defendants Kenneth Lipper and Lipper & Company, Inc., and the Clerk is directed to enter judgment dismissing all cross-claims asserted against said moving defendant; and it is further

ORDERED that the cross-motion for partial summary judgment by defendant Kenneth Lipper against defendant PricewaterhouseCoopers LLP is denied.

Dated: April 24, 2013

ENTER:



J.S.C.

FILED

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