SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK:COMMERCIAL DIVISION

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THEO BULLMORE and PHILLIP S. STENGER, as Joint Official Liquidators of BEACON HILL MASTER LTD. (In Official Liquidation),

Plaintiffs,

Index No. 104314/05

- against -

ERNST & YOUNG CAYMAN ISLANDS, ERNST & YOUNG LLP, BEACON HILL ASSET MANAGEMENT, LLC, JOHN D. BARRY, THOMAS DANIELS, JOHN IRWIN, MARK MISZKIEWICZ, and ATC FUND SERVICES (CAYMAN) LIMITED f/k/a ATC FUND ADMINISTRATORS (CAYMAN) LIMITED,

Defendants.

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Charles Edward Ramos, J.S.C.:

In motion sequence 1, defendant Ernst & Young LLP ("E&Y LLP"), moves to dismiss the complaint.

In motion sequence 2, defendant Beacon Hill Asset Management, LLC, and defendants John Barry, Mark Miszkiewicz, Thomas P. Daniels and John Irwin, move to dismiss the complaint.

In motion sequence 3, defendant Ernst & Young Cayman Islands ("E&Y Cayman"), moves to dismiss the complaint.

In motion sequence 4, defendant ATC Fund Services [Cayman] Limited ("ATC"), moves to dismiss the complaint.

The above motions are herein consolidated for disposition and are disposed of in accordance with the following memorandum.

Background

This action arises out of the collapse of three hedge funds in an alleged valuation fraud scheme.

The action was instituted by plaintiffs Theo Bullmore and Phillip Stenger, the appointed joint official liquidators of plaintiff hedge fund Beacon Hill Master Ltd. ("Master Fund"), a Caymanian exempted company, currently winding up pursuant to the Cayman Islands Companies Law. The Master Fund is comprised of three feeder hedge funds.

Defendant Beacon Hill Asset Management, LLC ("Beacon Hill"), by its four principals, the individually named defendants Barry, Daniels, Irwin and Miszkiewicz (collectively, the "Beacon Hill Defendants"), was the investment manager for the Master Fund, which holds the investment assets of, and conducts trading for the three feeder hedge funds which comprise the Master Fund.[1]

Pursuant to an investment management agreement ("Agreement"), Beacon Hill was to manage and value securities in the Master Fund's portfolio, according to specified valuation procedures and given nearly complete discretion in effecting transactions on the Master Fund's behalf. Beacon Hill's compensation was based, in part, on the pro rata share of the combined assets and performance of the Master Fund's portfolio in addition to an incentive fee based upon the percentage of net

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[1] The three feeder funds are Bristol Fund, Ltd. ("Bristol"), Safe Harbor Fund, L.P. ("Safe Harbor"), and Milestone Plus Partners, L.P. ("Milestone")(collectively, the "Feeder Funds").

The Feeder Funds were managed independently by Beacon Hill until January of 2002, when Beacon Hill changed its management approach to a master feeder fund structure where all trading was collectively conducted pursuant to a single investment strategy.

appreciation and the net asset value ("NAVs"),[2] of the Master Fund's securities (Agreement, § 9).

According to the complaint, the Beacon Hill Defendants failed to adhere to the valuation methodology[3] detailed in the various agreements between the parties, which required Beacon Hill to utilize values calculated by Bear Stearns if readily available,[4] instead utilizing their own manipulative valuation methods, which included unauthorized "hedge adjusted" valuing, followed by defendant Daniels' or Irwin's manual adjustments of the values.

The valuation method utilized by Beacon Hill allegedly resulted in a vastly misrepresented value of the Master Fund's portfolio; while Beacon Hill was allegedly representing that the Master Fund's values were stable and growing steadily, Beacon

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[2] A fund's NAV is intended to constitute a direct measure of a hedge fund's performance.

[3] The Agreement, offering memorandum and the Master Fund's Articles of Association for each of the three Feeder Funds state that the value of the securities in the Feeder Fund's portfolio will be calculated using (1) market prices, when available, (2) if such prices are not available, prices were to be obtained by a reputable third party broker-dealer, and (3) only if such prices cannot be otherwise obtained, the Beacon Hill Defendants were to determine the fair value of the Master Funds' securities in good faith.

[4] Bear Stearns served as the Master Fund's prime broker and custodian. In this capacity, the Master Fund's CMOs served as collateral for the its obligations to Bear Stearns whereby Bear Stearns purchased the CMOs with the agreement to re-sell them to the Master Fund at a later date, and vice versa. Because of this relationship, Bear Stearns constantly monitored the value of the CMOs, allegedly valuing the securities daily. Beacon Hill allegedly had access to all of Bear Stearns' valuation yet chose to disregard them.

Hill was actually concealing erratic returns and mounting and substantial losses.

Defendants E&Y Cayman and E&Y LLP (collectively, the "E&Y Defendants"), performed, allegedly in conjunction, the first and only audit of the Master Fund covering the period from the Master Fund's inception in January of 2002 through March 31, 2002. E&Y Cayman was retained to conduct the audit pursuant to a retainer agreement, while E&Y LLP allegedly performed some of the audit work. One of E&Y LLP's junior accountants, Bryan Ryder, allegedly emerged to become the lead auditor of the Master Fund. At the conclusion of the audit, E&Y Cayman issued a "clean" audit report, attesting to the fair presentation of the Master Fund's financial statements in conformity with generally accepted auditing standards ("GAAS").

Plaintiffs allege that the E&Y Defendants failed to verify the valuation methods utilized by Beacon Hill and that if an adequate audit had been conducted, the misrepresented values would have been discovered.

Defendant ATC, as the Master Funds' administrator, was responsible for determining the Master Fund's NAVs, based upon the values supplied by Beacon Hill, in addition to maintaining the Fund's books and preparing annual financial statements. Plaintiffs allege that ATC additionally failed to verify that the securities were accurately valued by the Beacon Hill Defendants by not conducting an independent valuation of the Master Fund's portfolio.

According to plaintiffs, Beacon Hill, by its four principals, hid the extent of the Master Fund's losses, which losses were further insulated by the alleged negligence of the remaining defendants, until the launch of an SEC investigation in October of 2002. Around this time, the Beacon Hill Defendants communicated to investors that the reported NAVs of the Master Fund's shares declined by twenty-five per cent in September and fifty-four per cent in August, prompting Bear Stearns to refuse to provide additional financing to the Master Fund.

On November 7, 2002, the SEC commenced an action against Beacon Hill and all four of the Beacon Hill Defendants in the Southern District of New York, alleging the material misrepresentation of the NAVs of the Master Fund's shares and corresponding returns to investors in violation of federal securities laws. The Beacon Hill Defendants consented to preliminary injunctive relief removing them as the Fund's manager and the entry of a final judgment against them, while not admitting liability. Beacon Hill was then ordered to disgorge $2.2 million in fees and to pay an additional $2 million in civil penalties.

By the time the Beacon Hill Defendants were removed as the Master Fund's manager on November 13, 2002, the Master Fund's reported NAVs had declined by sixty-one per cent as of August of 2002.

Investors in the Feeder Funds commenced an action in the Southern District of New York in April of 2003 arising out of the

collapse of the Funds and asserting several federal securities law claims against Beacon Hill, its principals, its largest shareholder, and ATC ("Investor Actions"). The court dismissed claims against Beacon Hill based upon misrepresentation of NAVs and promises to value in good faith occurring prior to April of 2002, and those based upon misstatements or omissions appearing in audited financial statements and due diligence questionnaires, other than those questionnaires based upon statements made in May and June of 2002 (*Fraternity Fund, Ltd., et al v Beacon Hill Asset Management LLC*, 376 FSupp2d 385 [SDNY July 6, 2005]).

The court sustained claims asserted against the Beacon Hill based upon alleged misstatements of NAVs that occurred between April through the fall of 2002, for breach of fiduciary duty (*Id* at 410), negligence, negligent misrepresentation (*Id* at 411), and punitive damages (*Id* at 412). Additionally, the claim for breach of contract claim asserted against Safe Harbor's general partner, Safe Harbor Asset Management, arising out of the alleged failure to value Safe Harbor's portfolio in good faith was sustained (*Id* at 412). Beacon Hill owned ninety-nine per cent of Safe Harbor Asset Management and Barry owned one per cent (*Id* at 392).

Subsequently, the court dismissed all claims asserted against ATC (*Fraternity Fund, Ltd., v Beacon Hill Asset Management LLC*, 376 FSupp2d 443, 447 [SDNY July 11, 2005]). Plaintiffs here seek to recoup the losses suffered by the Master Fund and assert ten causes of action: (1) professional

malpractice against the E&Y Defendants; (2) aiding and abetting breach of fiduciary duty against the E&Y Defendants; (3) breach of contract against Beacon Hill; (4) breach of the fiduciary duty of care against the individual Beacon Hill Defendants; (5) negligence against the Beacon Hill Defendants; (6) breach of fiduciary duty against ATC; (7) aiding and abetting breach of fiduciary duty against ATC, (8) breach of contract against ATC; and (9) breach of the fiduciary duty of self-dealing against the individual Beacon Hill Defendants.

Discussion

Under CPLR 3211(a)(7), facts pleaded in the complaint are presumed to be true and will be accorded every favorable inference if they fit within a legally cognizable claim (*Wilson v Hochberg*, 245 AD2d 116, 116 [1st Dept 1997]).

1. Claims Asserted Against Beacon Hill

A. Breach of Contract

The Agreement executed between the Master Fund and Beacon Hill contains a choice of law provision calling for the application of New Jersey law to govern the Agreement. New York courts typically uphold choice of law provisions unless the jurisdiction whose law is to be applied bears no reasonable relationship to the agreement or enforcement of the provision would violate New York public policy (*Finucane v Interior Const. Corp.*, 264 AD2d 618, 620 [1st Dept 1999]).

Here, neither party disputes the applicability of New Jersey

law to the breach of contract claim and the court discerns a reasonable relationship between the state of New Jersey and the Agreement itself, predicated upon Beacon Hill and the individual Beacon Hill defendants' principal residency in that state. Further, the court finds no violation of New York public policy by the application of New Jersey contract law principles to the Agreement.[5] Accordingly, the court applies New Jersey law to plaintiffs' breach of contract claim.

Plaintiffs' claim for breach of contract arises out of Beacon Hill's failure to adhere to the valuation scheme set forth in the Agreement. Under the Section 15 [b] of the Agreement, Beacon Hill was obligated to value the securities in the Master Fund portfolios "based on the broadest and most representative market for such security", according to a specified valuation formula.[6] The Agreement provided that Beacon Hill had discretion to value the securities of the Master Fund's portfolio in *good faith* only when market quotations were not available.

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[5] Plaintiffs maintain that enforcement of the exculpation and indemnification clause violates New Jersey public policy. For reasons discussed below, the court rejects this argument.

[6] According to the Agreement, (1) all securities were to "be valued as at the last sale price on such [securities] exchange on the Valuation date"; (2) securities sold over the counter were to be valued "at the most recent quoted bid price provided by one or more principal market makers" unless in Beacon Hill's opinion, that value does not "fairly indicate the market value" of the security and Beacon Hill may "rely on the value obtained from a reputable broker-dealer"; and (3)securities for which market quotations are not readily available are to be valued "at their fair value as determined in good faith in accordance with the procedures adopted by the Investment Manager [Beacon Hill]" (Agreement, § 15 [b]).

According to the complaint, even when market quotations for the securities were readily available from Bear Stearns, Bloomberg and other reputable broker-dealers, Beacon Hill disregarded such values and instead valued the securities itself by manipulative "hedge adjusted" pricing, followed by further manipulations, in order to create the false impression of steady and increasing growth and to conceal the Master Fund's growing losses. (Complaint, ¶ 35). That Beacon Hill's own compensation was tied to the performance Master Fund's portfolio (Agreement, § 9), allegedly provided the motive to misrepresent higher values.

In attempting to demonstrate one aspect of the manipulative scheme, plaintiffs submit a list of values calculated by Bear Stearns, Bloomberg and IDC for the month of March, 2002, for the Master Fund's portfolio, followed by a list of values calculated by Beacon Hill for the same time period (Complaint, § 37), to establish that Beacon Hill calculated values despite the availability of these values and in contravention of section 15 [b] of the Agreement, which granted Beacon Hill discretion to independently value securities *only* when they were not available from broker-dealers.

Moreover, in support of allegations that the breach, predicated upon the departure from the Agreement's valuation scheme and the disregard for available broker-dealer values, was done in bad faith, plaintiffs point out that the values calculated by the three broker-dealers are largely consistent with one another in that they varied only by one point, while the

valuations calculated by Beacon Hill for the same time period are drastically higher, varying from the broker-dealer values by five to ten points (Complaint, ¶ 37).

Beacon Hill maintains that the claim for breach of contract fails because plaintiffs have failed to allege that the Bear Stearns prices represent market quotations within the meaning of the Agreement. However, the complaint repeatedly asserts that the Bear Stearns and Bloomberg values represent the type of values that Beacon Hill was contractually obligated to rely on to value the Fund's securities if "readily available", within the meaning of § 15 [b] of the Agreement.[7]

To the extent that plaintiffs have identified a contractual provision, an obligation set forth therein and conduct in contravention of that obligation, plaintiffs have sufficiently plead a cause of action for breach of contract under New Jersey law. The claim may be barred by the exculpation and indemnification clause contained in the Agreement, however, which

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[7] *See* Complaint, ¶ 39, "Both before and after commencement of the Master Fund, the Bear Stearns' values reflected a reasonable valuation of the Feeder and Master Funds' position. Beacon Hill's valuations ... did not"; ¶ 90, "Bear Stearns values were available for a much larger portion of the portfolio - approximately 85% of the Master Fund's CMOs [collateralized mortgage obligations]"; ¶ 128, "Notwithstanding the fact that independently determined values were available to Beacon Hill for CMOs in the Master Fund's portfolios - both from public sources such as the Bloomberg pricing service and from broker-dealers, such as Bear Stearns - Beacon Hill chose to value the CMOs using its own hedge-adjusted spreadsheet".

plaintiffs assert is void as violating New Jersey public policy.[8]

Under New Jersey law, indemnification and exculpation clauses are generally upheld unless they are unconscionable and violate public policy (*Hillside v Lehigh V.R. Co.*, 232 A2d 683, 685 [NJ App Div 1967]), or if "the party benefitting from exculpation is subject to a positive duty imposed by law" (*Chemical Bank, N.A. v Bailey*, 687 A2d 316, 321 [NJ App Div 1997], *cert denied* 695 A2d 671 [NJ Sup Crt 1997]). Unconscionability hinges on the parties' relative bargaining positions (*Lucier v Williams*, 841 A2d 907, 911-912 [NJ App Div 2004]), and the clarity of the clauses' language (*Lucier, supra*, 841 A2d at 911-912). Further, New Jersey courts tend to disfavor exculpatory clauses in contracts for professional services in order to protect the individual relying on the professional's expertise and advice (*Id*).

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[8] Agreement, § 13, "Exculpation; Indemnification: The Investment Manager [Beacon Hill], and its members ... shall not be liable for any acts or omissions or any error of judgement or for any loss suffered by the [Master] Funds in connection with the subject matter of this Agreement, except loss resulting from willful misfeasance, bad faith or gross negligence in the performance by such of its obligations and duties hereunder or by reason of such person's reckless disregard of its obligations and duties ... The Funds shall ... indemnify the Investment Manager and its members ... against any and all costs, losses, claims, damages or liabilities ... except that an Indemnified Person will not be indemnified for Losses that are ultimately determined to be the result of ... willful misfeasance".

The clause additionally provides that the Master Fund advance to the indemnified party, reasonable attorneys' fees incurred in connection with the defense of any action arising out of Beacon Hill's acts.

Plaintiffs rely on *Ehrlich v First Nat'l Bank of Princeton*, 505 A2d 220, 233-237 [NJ Super Crt 1984], as authority for voiding the limitation of liability clause in the Agreement. That reliance is misplaced, however, as the clause at issue in *Ehrlich* exculpated the defendant investment advisor for *any* good faith act and failed to distinguish between degrees of negligence (*Id*). Further, the facts of the case suggest that the acts at issue constituted gross negligence or even recklessness (*Id* at 226-227, 233, 237).

Here, unlike in *Erlich*, the clause limits Beacon Hill's liability for acts of ordinary negligence only and does not seek to exculpate it for grossly negligent acts or intentional malfeasance (Agreement, § 13). Further, the *Erlich* court predicated its holding upon the parties' vastly unequal bargaining power, where plaintiff was an unsophisticated investor and the investment advisor, a bank, was highly sophisticated (*Id* at 233). Moreover, the court invalidated the clause's applicability to plaintiff's tort claims and expressly did not reach the breach of contract claim (*Id* at 233).

Finally, New Jersey courts have declined to extend *Erlich*'s holding to void limitations on liability clauses except in limited instances where the clause seeks to exculpate a party for *all* negligent acts, including those that are grossly negligent, where the parties' bargaining power is vastly unequal, or in an adhesion contract (*See Lucier, supra*, 841 A2d at 911-912, home inspection agreement containing exculpation clause that capped

the financial liability of home inspector at $500 for any claims, including for gross negligence, ruled void against public policy where agreement was adhesive in nature, language was "confusing and unfair", plaintiffs were unsophisticated first-time home buyers and where the clauses' cap on financial recovery effectively avoided any responsibility for negligence; *see also Mango v Pierce-Coombs*, 851 A2d 62, 70 [NJ App Div 2004], relying on *Erlich*, court voided exculpation clause in septic system inspection certification where certification specifically disclaimed any warranty as to the system's working condition which acted to obliterate the purpose for which the inspector was hired and where facts indicated that the acts at issue, failing to detect that the system needed to be entirely replaced and redesigned, despite certification that the system was in working condition, likely amounted to gross negligence).

This rule has not been extended to sophisticated parties relying on one another's professional expertise (*Chemical Bank, N.A., supra*, 687 A2d at 322, court refused to void exculpation clause in real estate mortgage agreement where there was no evidence of unequal bargaining power between the parties and both were sophisticated, regularly dealt with contract liability and the clause unambiguously allocated the division and expense of loss; *see also* as to sophistication of the parties, *Eichenholtz v Brennan*, 52 F3d 478, 484-486 [3rd Cir 1995], contractual indemnification held not to apply to federal securities claims where indemnification would run counter to Congress' concern to

protect unsophisticated investors from fraudulent practices).

Plaintiffs' assertion that the Agreement is adhesive is unsupported by any allegation of ambiguity in the clause itself or of unequal bargaining power between the parties. Rather, the plain language of the clause, clearly set out in the middle of the Agreement, is unambiguously clear in allocating the risk of loss caused by Beacon Hill's ordinary negligence to the Master Fund, whereas Beacon Hill remains liable for losses caused by its own grossly negligent acts and for any intentional wrongdoing. Neither have plaintiffs pointed to language purporting to undermine its clarity (*compare Tannock v NJ Bell Telephone Co.*, 515 A2d 814 [NJ Super Crt 1986], *revd on other grounds* 537 A2d 1307 [NJ App Div 1987], exculpatory clause unenforceable where "the print is too small to be read by an average person without the aid of a magnifying glass").

Moreover, plaintiff's assertion that members of the Master Fund's independent board of directors, signatories of the Agreement, were dominated by Beacon Hill is entirely unsubstantiated. In order to survive such an allegation, plaintiffs would have to establish that the Master Fund's board was dominated to the point that it effectively had no choice but to accept the terms of the Agreement (*Vasquez v Glassboro Service Ass'n, Inc.*, 415 A2d 1156 [NJ Sup Crt 1980]).

Plaintiffs make no allegation that would lead this court to believe that either the Master Fund's board or Beacon Hill negotiated with anything short of unmitigated freedom of

contract.

Finally and perhaps most significantly, the clause at issue seeks to exculpate Beacon Hill for acts of ordinary negligence only and not gross negligence or intentional malfeasance. Accordingly, plaintiffs have not demonstrated that enforcement of the exculpation clause violates New Jersey public policy.[9] Therefore, to the extent that the Agreement's exculpation and indemnification clause is enforceable, the clause bars plaintiffs' claims of ordinary negligence, but does not insulate Beacon Hill from liability for those acts of wilful malfeasance.

Despite the enforceability of the exculpation and indemnification clause, plaintiffs' claim for breach of contract is not barred, however. Plaintiffs have sufficiently pled facts of intentional wrongdoing and/or grossly negligent conduct at the pleading stage, arising out of Beacon Hill's alleged failure to adhere to the contractual valuation scheme, and instead manipulating values to offset any movement in the price of the US treasury investments in the Master Fund's portfolio. To support these artificial values, Beacon Hill allegedly "cherry-picked"

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[9] Neither would plaintiffs achieve a different result under New York law, which similarly holds that in the absence of contrary statutory authority, a contractual provision absolving a party from its own ordinary negligence is enforceable, while a party may not insulate herself from liability for gross negligence or willful conduct, including in the commercial context (*Sommer v Federal Signal Corp.*, 79 NY2d 540, 553-554 [1992]; *but see* GOL § 5-322.1, agreements exempting general contractors in construction agreements from liability for ordinary negligence are void; *and* GOL § 5-326, agreements exempting amusement parks and recreational facilities from liability for ordinary negligence are void).

third-party values from various sources to support its valuations, in order to create the impression of a steadily increasing portfolio.

Further, the Agreement itself imposed upon Beacon Hill a duty to value securities in good faith in the event that market quotations were not available (Agreement, § 15 [b]). However, even in the absence of the Agreement's express contractual obligation on the part of Beacon Hill to value in good faith, defendants' alleged bad faith breach would be actionable under New Jersey law as a breach of the implied covenant of good faith and fair dealing (*Brunswick Hills Racquet Club, Inc. v Route 18 Shopping Ctr.*, 864 A2d 387, 395-396 [NJ Sup Crt 2005], "Every party to a contract ... is bound by a duty of good faith and fair dealing both in the performance and enforcement of the contract ... A defendant may be liable for a breach of the covenant of good faith and fair dealing even if it does not violate an express term of a contract"; *Wilson v Amerada Hess Corp.*, 773 A2d 1121, 1126 [NJ Sup Crt 1999], "Implied covenants are as effective as those covenants that are express"; *see also Bak-A-Lum Corp. v Alcoa Building Prods.*, 351 A2d 349 [NJ Sup Crt 1976], defendant found to have violated covenant of good faith and fair dealing, despite not having violated any express terms of the agreement, where vital information was withheld from plaintiff for the purpose of exploiting the terms of the agreement without regard to the harm caused to plaintiff).

Therefore, as plaintiffs have pled facts of bad faith and

grossly negligent conduct, the exculpation and indemnification clause will not bar plaintiffs' claims. In the event that the fact-finder determines at a later stage in this action that Beacon Hill's conduct was neither grossly negligent nor motivated by bad faith, the clause will necessarily be triggered. However, it is premature to make this determination on a motion to dismiss the complaint where the court's inquiry is limited to the four corners of the complaint (*compare Tessler & Son v Sonitrol Sec. Sys.*, 497 A2d 530 [NJ Super Crt App Div 1985], despite plaintiff's allegations of gross and wanton negligence, evidentiary record established at trial supported only negligent contract performance and thus exculpatory clause limiting liability for ordinary negligence was enforceable to limit plaintiff's recovery; *see* also *Stuyvesant Assocs. v Doe*, 534 A2d 448, 450 [Law Div 1987], the differences between ordinary and gross negligence is a matter of degree and is to be determined by the fact-finder).

The Agreement additionally provides that plaintiffs will bear Beacon Hill's litigation costs unless and until intentional and/or gross negligent conduct is determined. Plaintiffs cite to no authority, either under New York or New Jersey law, propounding the principle that litigation fee shifting clauses incident to an agreement to exculpate is void against public policy. While New Jersey tends to disfavor shifting litigation fees in recognition of the policy that each party bear their own litigation costs, contractual provisions providing for fee

shifting are enforceable (*Dare v Freefall Adventures*, 793 A2d 125, 135 [App Div 2002], *cert denied* 803 A2d 638 [NJ Sup Crt 2002]).

Here, the clause's language that "the [Master] Funds shall advance to each Indemnified Person ... reasonable attorney's and other costs and expenses incurred in connection with the defense of any action ... arising out of such acts ... each Indemnified Person agrees, that in the event it receives any such advance, it shall reimburse the Funds for such fees ... to the extent that it shall be determined that it was not entitled to indemnification", can only be read as an agreement that the Master Fund would front Beacon Hill and its principals' litigation costs unless and until it is determined that Beacon Hill and/or its principles are determined to have acted in gross negligence or in bad faith (Agreement, § 13).

Accordingly, given the enforceability of the limitation of liability clause, plaintiffs are required to pay Beacon Hill's reasonable litigation fees, "to the extent that the Funds have available assets and need not borrow to do so" (Agreement, § 13), unless and until it is determined that Beacon Hill's conduct was willful or grossly negligent, whereupon Beacon Hill must reimburse such fees to the Master Fund. Where, as here, two sophisticated parties have contracted and in the absence of unconscionability or the violation of public policy, the court's role is limited to enforcing the Agreement as written (*Commercial Bank of NJ, supra*, 687 A2d at 322, "In a commercial setting, the

judiciary will not undertake the writing of a different or better contract between the parties"; *Saxon Const. & Management Corp. v Masterclean*, 641 A2d 1056, 1058 [NJ App Div 1994], *cert denied* 645 A2d 142 [NJ Sup Crt 1994]).

2. Claims Asserted Against the Individual Beacon Hill Defendants

A. Breach of the Fiduciary Duty of Care and Self- Dealing

Notwithstanding the application of New Jersey law to the Agreement, both parties inconsistently cite to New York, New Jersey law and Delaware[10] tort law with respect to plaintiffs' tort claims, although neither party maintains that an actual conflict between each states' law exists.

Under New York law,[11] a choice of law provision does not mandate application of that state's law to a plaintiff's tort claims unless the choice of law provision itself is so broad as to encompass the entire relationship between the parties (*Turtur v Rothschild Registry International, Inc.*, 26 F3d 304, 309 [2nd Cir 1994]; *see also* as to New York courts' "reluctance" to read choice of law clauses broadly, *Finance One Public Co. Ltd.*,

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[10] Claims involving corporate governance and the corresponding duties of officers and directors and their relation to the corporation are governed by the applicable laws of the state of incorporation (*Hart v General Motors Corp.*, 129 AD2d 179, 182 [1st Dept 1987], *app denied* 70 NY2d 608 [1987]). While Beacon Hill was incorporated in Delaware, the tort claims at issue are unrelated to either Beacon Hill's corporate governance or the duties to the corporation itself, and thus Delaware law does not apply to plaintiffs' tort claims.

[11] New York courts determine the scope of choice of law clauses under New York law, and not under the law selected by the clause (see Finance One Public Co. Ltd. v Lehman Bros., 414 F3d 325, 333 [2nd Cir 2005]).

supra, 414 F3d at 334).

Therefore, a choice of law provision that is narrow in scope will trigger application of that state's substantive laws only to those claims sounding in contract and not those sounding in tort (*Lazard Freres & Co. v Protective Life Ins. Co.*, 108 F3d 1531, 1540 [2nd Cir 1997]; *J.A.O. Acquisition Corp. v Stavitsky*, 192 Misc2d 7, 11 [Sup Ct NY County 2001], *affd* 293 AD2d 323 [1st Dept 2002]).

Here, the scope of the choice of law provision is narrow, calling for application of New Jersey law to the "terms and provisions" of the Agreement only (Agreement, § 21), rather than calling for a broader application that encompasses all disputes arising between the contracting parties (*compare Internet Law Library, Inc. v Southbridge Capital Mgmt., LLC*, 223 FSupp2d 474, 489 [SDNY 2002], contract's choice of law provision sufficiently broad as to cover all disputes between the contracting parties, including tort claims). Therefore, due to the narrowness of the clause, application of New Jersey law to the tort claims is not mandated and a potential choice of law issue is presented (*J.A.O. Acquisition Corp., supra*, 192 Misc2d at 11).

Any choice of law analysis necessarily begins with the examination of whether there is an actual conflict between New York and New Jersey law regarding the coexistence of a claim for breach of fiduciary duty and breach of contract (*J.A.O. Acquisition Corp., supra*, 192 Misc2d at 11; *Elson v Defren*, 283 AD2d 109, 114 [1st Dept 2001]). In the event that no meaningful

conflict exists, no choice of law analysis need be undertaken (*Id*).

Here, both New York and New Jersey laws are sufficiently similar that no actual conflict exists in relation to plaintiffs' claims (*compare Saint Patrick's Home v Laticrete*, 267 AD2d 166, 166-167 [1st Dept 1999], "A tort action may be asserted in an action for breach of contract where the underlying agreement gives rise to a duty or confidential relationship independent of the contract obligation"; *and McKelvey v Pierce*, 800 A2d 840, 859 [2002], a breach of fiduciary claim requires proof of the existence and breach of a confidential relationship").

Therefore, because no discernible difference exists in the laws of the two states, no choice of law analysis need be undertaken (*Tronlone v Lac d'Amiante Du Quebec, Ltee*, 297 AD2d 528, 529 [1st Dept 2002], *lv appeal granted* 300 AD2d 1155 [1st Dept 2002], *affd* 99 NY2d 647 [2003]), and the law of the forum state where the action is being tried, New York, is to be applied to plaintiffs' tort claims (*Excess Ins. Co. Ltd. v Factory Mut. Ins. Co.*, 2 AD3d 150, 151 [1st Dept 2003], *order affd* 3 NY3d 577 [2004]; *SNS Bank, N.V. v Citibank, N.A.*, 7 AD3d 352, 354 [1st Dept 2004]).

Turning to plaintiffs' claim, under New York law, a fiduciary relationship exists where one party is under a duty to act or give advice for the benefit of others, or where there is a special relationship of trust and confidence (*Mandelbatt v Devon Stores, Inc.*, 132 AD2d 162, 168 [1st Dept 1987]). The same

conduct constituting breach of contract may also constitute the breach of a duty arising out of that contractual relationship, however only where such duty is asserted as existing independently of the contract itself (*Id*).

Therefore, a claim for breach of fiduciary duty can coexist with a claim for breach of contract only where plaintiff has pled facts which do not also constitute elements of the contract (*Clark-Fitzpatrick, Inc. v Long Island, R.R., Co.*, 70 NY2d 382, 389 [1987]).

No such distinction exists amidst plaintiffs' allegations, however. Rather, plaintiffs largely repeat the allegations set forth in support of its breach of contract claim. The facts plaintiffs pled are identical to and constitute elements of its breach of contract claim and the conduct referred to as constituting the breach of the Agreement is the same conduct alleged to constitute the breach of fiduciary duty, specifically the failure to adhere to the valuation scheme set forth in the Agreement (*Clark-Fitzpatrick, Inc., supra,* 70 NY2d at 389; *see also Pane v Citibank, N.A.*, 19 AD3d 278, 279 [1st Dept 2005], a formal written agreement covering the precise subject matter of the alleged fiduciary duty states a claim for breach of contract only). Plaintiffs' claim for breach of the fiduciary duty of care is therefore duplicative of the breach of contract claim.

In contrast to the claim for breach of the fiduciary duty of care, plaintiffs do plead facts sufficient to state a claim for

breach of the fiduciary duty of self-dealing that is separate and distinct from Beacon Hill's contractual obligations under the Agreement.

New York courts have long held that the delegation of discretionary trading authority by a client to its broker, which relationship the court finds akin to that relationship between Beacon Hill, as investment manager, and the Master Fund, the holder of assets of three separate hedge funds, gives rise to a general fiduciary duty (*Bissell v Merrill Lynch & Co., Inc.*, 937 FSupp 237, 246 [SDNY 1996], *affd* 157 F3d 138 [2nd Cir 1998], *cert denied* 525 US 1144 [1999]).

A fiduciary owes a duty of undivided loyalty to those whose interests the fiduciary is charged to protect. This duty includes the obligation to avoid situations in which the fiduciary's personal interests conflict with the interest of those owed the fiduciary duty (*Ajettix Inc. v Raub*, 9 Misc 3d 908, 913 [Sup Crt NY County 2005]).

Here, the Master Fund relied exclusively on Beacon Hill to provide investment management services and delegated full discretionary authority to Beacon Hill to advise, effect, purchase, sell manage and value transactions on behalf of the Master Fund and relied primarily on Beacon Hill to value the Master Fund's portfolio. In addition to being given sole authority to purchase and sell securities on behalf of the Master Fund, Beacon Hill was granted authority to value securities in the portfolio, upon which the Master Fund's NAVs were calculated.

By virtue of this relationship, the Master Fund allegedly placed confidence in Beacon Hill such that it relied on Beacon Hill's superior knowledge, experience and expertise (*See Sergeants Benev. Ass'n Annuity Fund v Renck*, 19 AD3d 107, 110 [1st Dept 2005]).

That the Agreement itself contains a clause wherein the Master Fund agreed that the parties' relationship was arms' length (Agreement, § 26 [a]), does not otherwise detract from the possibility of the existence of a fiduciary duty. A fiduciary relationship need not be formalized in writing; it is the ongoing conduct between the parties which may give rise to such a relationship (*Frydman & Co. v Credit Suisse*, 272 AD2d 236, 237 [1st Dept 2000]), even if the contract between the parties expressly disavows it (*See EBC I, Inc. v Goldman Sachs & Co.*, 5 NY3d 11, 19-20 [2005], "[F]iduciary liability is not dependent solely upon an agreement or contractual relation between the fiduciary and beneficiary but results from the relation"; *compare Kingdom 5-KR-41, Ltd. v Star Cruises PLC*, 2004 WL 359138, *7 [SDNY 2004], breach of fiduciary duty claim dismissed where agreement between bank and agent expressly disavowed such a relationship *and* where plaintiff only conclusorily alleged facts giving rise to such a relationship).

As for the alleged breach of that duty, plaintiffs allege that while serving as investment manager to the Master Fund, Beacon Hill additionally served as investment manager for two

unrelated accounts, Beacon Hill/HSBC Managed Trust ("HSBC") and Lyxor Master ("Lyxor"). In this capacity, Beacon Hill effected a series of trades between the two accounts and the Master Fund, allegedly at the direct expense of the latter, by selling CMOs to HSBC and Lyxor at prices substantially higher than the purchase price HSBC and Lyxor had paid for them just days earlier and above the IDC value for the corresponding date.

Additionally, plaintiffs allege that Irwin, Daniels and Barry arranged for Beacon Hill to sell two CMOs from the Master Fund to their own personal trading fund, named Asset Risk Management, LLC ("ARM"), at a price substantially lower than the value Beacon Hill had assigned to the securities, generating $500,000 in profit for ARM. Subsequently, just prior to Beacon Hill's announcement of the Master Fund's substantial losses, Barry, Irwin and Daniels liquidated the ARM by selling nine of its target bonds to the Master Fund, generating a profit of $16 million for the Beacon Hill Defendants which were then allegedly transferred out of the ARM account into another fund in their wives' names.

Plaintiffs' allegations regarding these transactions sufficiently state a claim for breach of the fiduciary duty of loyalty, predicated upon the Beacon Hill Defendant's purported self-dealing by arranging and executing trades that were designed to benefit them and which were detrimental to the Master Fund, by depleting the Master Fund's assets.

The Beacon Hill Defendants argue that they are relieved from

any liability for these acts because the Master Fund permitted this very conduct, pointing to several contractual provisions which purportedly authorize Beacon Hill to engage in self-dealing. Full knowledge of the alleged breach of trust and the surrounding circumstances is necessarily a requisite to any validation of the alleged breach, however. Plaintiffs here cannot be said to have validated an act before it has occurred and in the absence of full disclosure (*Santaro v Jack of Hearts*, 800 NYS2d 356, _ [Sup Crt Onondaga County 2005], *affd* 23 AD3d 1073 [4th Dept 2005]).

As for the parties' individual liability, the Beacon Hill Defendants maintain that as members of a limited liability company organized under Delaware law, they are shielded from individual liability pursuant to Delaware statute.[12] Because section 18-303 [a] of the Delaware Limited Liability Act protects members of a limited liability corporation from the liabilities of the LLC, the court must determine whether the individual Beacon Hill Defendants here are being sued solely by reason of their membership in Beacon Hill (6 Del C § 18-303 [a]), where the claim for breach of the fiduciary duty of self-dealing is based upon Barry, Irwin and Daniels' alleged purchase and sale of

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[12] *See* 6 Del C § 18-303 [a], "the liabilities of a limited liability company, whether arising in contract, tort or otherwise, shall be solely the ... liabilities of the limited liability company, and no member or manager of a limited liability company shall be obligated personally for any such ... liability of the limited liability company solely by reason of being a member".

Master Fund assets to their personal trading fund and subsequently transfer to their wives' personal accounts.

Under New York law, members of an LLC may be held personally liable "if they participate in the commission of a tort in furtherance of company business" (*Rothstein v Equity Ventures, LLC*, 299 AD2d 472, 274 [2nd Dept 2002]). The Beacon Hill Defendants' valuation of the Master Fund's portfolio was done by virtue of Beacon Hill's retention as investment manager to the Master Fund. Therefore, all the individual defendants' acts done in furtherance of the provision of investment management services are services performed due to their membership in the LLC. Consequently, the corporate veil of Beacon Hill may not be pierced and plaintiffs may not seek to hold the four Beacon Hill principals personally liable for their claims against Beacon Hill stemming from Beacon Hill's alleged participation in the manipulative valuation scheme.

As for plaintiffs' allegations regarding Barry, Daniels and Irwin's alleged self-dealing, they do not constitute acts done solely as members of an LLC or in furtherance of company business. Accordingly, plaintiffs may proceed on their claim for breach of the fiduciary duty of self-dealing against Barry, Daniels and Irwin. However, as all allegations regarding Miszkiewicz involve acts done solely on behalf of Beacon Hill, plaintiffs' claim against Miszkiewicz fails.

Finally, Beacon Hill maintains that New York's Martin Act,

which governs claims for fraud and deception in the distribution, sale and purchase of securities, bars plaintiffs' claim for breach of fiduciary duty. The Martin Act grants the Attorney General authority to enforce New York's securities laws (NY Gen Bus Law § 352), and does not require proof of scienter. Therefore, claims for breach of fiduciary duty, which do not require proof of scienter, arising out of securities transactions are covered by the Act (*Id*). There is no private right of action for claims that are within the purview of the Act (*Id*).

The Martin Act does not preclude plaintiffs' claim for breach of fiduciary duty of self-dealing against Barry, Daniels and Irwin as much of the conduct plaintiffs allege was not confined to New York but additionally occurred in New Jersey.

Therefore, for the reasons stated above, the motion to dismiss the claim for breach of the fiduciary duty of care is granted as to all Beacon Hill Defendants. The motion is additionally denied insofar as the claim for breach of the fiduciary duty of self-dealing is asserted against Beacon Hill, Barry, Irwin and Daniels and granted as to Miszkiewicz.

B. Negligence

Plaintiffs' claim for negligence merely restates the other claims for breach of contract and breach of fiduciary duty, and is therefore dismissed as duplicative (*Guerrand Hermes v JP Morgan*, 2 AD3d 235, 238 [1st Dept 2003], *lv appeal denied* 2 NY3d 707 [2004]).

3. Claims Asserted Against the E&Y Defendants

E&Y Cayman raises forum non conveniens and the defense of release as grounds for dismissal.

A. Forum Non Conveniens

Pursuant to CPLR 327, a court may stay or dismiss an action if in "the interest of substantial justice", the action should be heard in another forum (CPLR 327 [a]). The rule itself "rests upon justice, fairness and convenience" (*Waterways Ltd. v Barclays Bank PLC*, 174 AD2d 324, 327 [1st Dept 1991]), and is "left to the sound discretion of the court" (*Shin-Etsu Chemical Co., Ltd. v 3033 ICICI Bank*, 9 AD3d 171, 175-176 [1st Dept 2004]).

The burden is on the defendant to demonstrate private or public interest factors which militate against the selected forum (*Waterways Ltd., supra*, 174 AD2d at 327; *see also Anagnostou v Stifel*, 204 AD2d 61, 62 [1st Dept 1994], noting that a defendant's burden on a motion to dismiss on forum non conveniens grounds is "heavy").

In weighing whether to dismiss in favor of another forum, courts consider the factual nexus between New York and the dispute, the availability of an alternative forum, the residency of the parties in addition to weighing the public and private interests involved (*Id*). No one factor is controlling (*Islamic Republic of Iran v Pahlavi*, 62 NY2d 474, 474 [1984], *cert denied* 469 US 1108 [1985]). "Unless the balance is strongly in favor of the defendant, the plaintiff's choice of forum should rarely be disturbed" (*Waterways Ltd. v Barclays Bank PLC*, 174 AD2d 324, 327

[1st Dept 1991]).

1. Factual Nexus Between New York and the Dispute

It is well-settled that the situs of the underlying dispute is a factor to be weighed by the court (*Islamic Republic of Iran, supra*, 62 NY2d at 478-479). Here, while several key transactions at issue in this action occurred elsewhere, significant events occurred in New York.

According to the complaint, the allegedly deficient audit conducted by E&Y LLP's employee, Ryder, was conducted in E&Y LLP's New York office. The Beacon Hill Defendants, ATC and the E&Y Defendants allegedly all had extensive contact and involvement with investors, brokers and financial analysts regarding the Master Fund in New York. Moreover, the Master Fund's assets themselves were held by the Fund's non-party custodian, Bear Stearns, in New York. Non-party Asset Alliance, the fifty percent owner of Beacon Hill, was incorporated in New York.

Another factor properly considered by the court on a motion to dismiss on forum non conviens grounds is the existence of parallel proceedings involving the same parties and subject matter (*Rostuca Holdings, Ltd. v Polo*, 246 AD2d 475, 475 [1st Dept 1998]). Parallel litigation involving the same course of conduct in Federal Court is a favoring factor in balancing whether the court should retain the action in the present forum (Id).

Here, several actions involving the Master Fund and many of

the same defendants are currently pending in the United States District Court for the Southern District, located in New York. Moreover, the appointment of plaintiff, Stenger, as receiver for the Safe Harbor fund was initiated by the SEC in its action against Beacon Hill, also commenced in the Southern District of New York.

E&Y Cayman's reliance on *World Point Trading PTE, Ltd. v Credito Italiano*, 225 AD2d 153, 161 [1st Dept 1996]), for the contrary position that the existence of parallel proceedings weighs towards dismissal in favor or another forum, is misplaced. In *World Point Trading*, the court noted as significant that an action involving the same subject matter at issue in the New York action was *already* pending in Italy (*Id*). The decisive factor weighing towards dismissal in favor of Italy as the more appropriate forum was that the plaintiff in the New York action could easily interpose its claims in the ongoing Italy action (*Id*).

Here, there is no action pending in the Cayman Islands involving either the subject matter of the present action or the same parties in a related matter. There are, however, four actions pending in the Southern District of New York involving the same Fund and in which E&Y Cayman is named. It is likely that discovery exchanged in that action is located in New York and will be relevant to this action (*Rostuca Holdings, Ltd., supra*, 246 AD2d at 475; *see* also Waterways *Ltd., supra*, 174 AD2d at 327, the location of key documents in New York is a factor

militating against dismissal on forum non conveniens grounds).

Notably, E&Y Cayman did not raise forum non conveniens in the Investor Actions pending in the Southern District of New York, just across the street from where this court sits (*See Excess Ins. Co., Ltd. v Factory Mut. Ins. Co.*, 285 AD2d 351, 351 [1st Dept 2001], *lv appeal dismissed* 97 NY2d 638 [2001], "Given the fact that, for four years, the parties ... tried an identical action ... in the United States District Court for the Southern District of New York, literally across the street from the New York County Courthouse, it was improvident to dismiss this action on forum non conveniens grounds ... defendant has not met its burden that of proving that New York County is an inconvenient forum").

2. Residency of the Parties

E&Y Cayman is correct in arguing that a plaintiff's residency outside of the forum state is a factor that militates against retention of New York County as the forum.

Here, many of the parties involved in this action are nonresidents of New York.[13] Given the global nature of this

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[13] Plaintiff Bullmore is a resident of the Cayman Islands and plaintiff Stenger is a resident of Michigan (Complaint, ¶ 8). The Master Fund itself is a Cayman Islands exempted company, while its "principal investment objective is to invest in United States of America fixed-income securities" (E&Y LLP notice of motion, Ex. 3), and the Feeder Funds it is comprised of were organized under Cayman Islands (Bristol), New Jersey (Safe Harbor), and Delaware (Milestone) law. The Master Fund's assets are held in New York by non-party custodian and broker, Bear Stearns, also located in New York.

Defendant E&Y Cayman was organized under the laws of the

action, however, as exemplified by the fact that all parties are dispersed around the world, organized under different states' laws, headquartered in different fora and not concentrated in one forum, E&Y Cayman has not demonstrated why the Cayman Islands would be more convenient (*Georgia-Pacific Corp. v Multimark's Intern. Ltd.*, 265 AD2d 109, 112 [1st Dept 2000], motion to dismiss on forum non conveniens grounds properly denied where defendants failed to identify a more convenient forum as all three parties involved were scattered around the world).

As for the location of witnesses, E&Y Cayman has identified several *potential* key witnesses located in the Cayman Islands that may not be subject to the personal jurisdiction of this court. It is likely that there are numerous other witnesses

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Cayman Islands and is an affiliate of defendant E&Y LLP, based in New York (Complaint, ¶ 9). Defendant E&Y LLP is a Delaware limited liability partnership, with its principal place of business located in New York (Complaint, ¶ 10).

Defendant Beacon Hill, while a Delaware limited liability company with its principal place of business in New Jersey (Complaint, ¶ 11), is fifty per cent owned by a New York corporation, Asset Alliance. The individual Beacon Hill Defendants Barry, Daniels, Irwin and Miszkiewicz maintain principals residences in New Jersey (Complaint, ¶ 12-15). All four of the Beacon Hill Defendants allegedly met with, spoke to and sent reports containing the alleged misrepresentations that are the gravamen of this action to investors located in New York (Complaint, ¶ 12-15), and New Jersey (Plain. Memo. of Law, pg. 46).

Defendant ATC is a Cayman Islands limited liability company with its principal place of business located in the Cayman Islands, although ATC allegedly derives substantial revenue from administration of hedge funds operated in New York and additionally, to send financial reports, including reports related to the Master Fund, to investors in New York (Complaint, ¶ 16).

located in New York, however, including employees of Master Fund custodian Bear Stearns and other New York based brokers and dealers who provided valuations of the Master Fund's portfolio positions to the Beacon Hill Defendants and to the E&Y Defendants. In any event, the presence of witnesses alone, even key witnesses, is not itself a determinative factor (*Anagnostou, supra*, 204 AD2d at 62, the presence of key witnesses is a significant factor but "it does not automatically override plaintiffs' choice of forum"), particularly where, as here, numerous witnesses will likely be located across the country in addition to the Cayman Islands.

Furthermore, while the court has considered that several individuals identified by E&Y Cayman as witnesses potentially may not be amenable to suit in New York, ultimately the court is not persuaded that the convenience of the parties would be served by the commencement of an action in the Cayman Islands merely to accommodate potentially impleaded parties. The likelihood of impleader remains pure speculation at this stage (*see Turner v Hudson Transit Lines, Inc.*, 724 FSupp 242, 244 [SDNY 1989]).

3. Availability of an Alternative Forum

Plaintiffs argue that the Cayman Islands is an inappropriate forum because of the unavailability of obtaining a jury trial there. The inability to obtain a trial by jury is a factor considered by courts as militating against the alternate forum (*see Gyenes v Zionist Organization of America*, 169 AD2d 451, 452 [1st Dept 1991]).

Moreover, that the court will likely have to apply Cayman Islands law, which arguably only affects the claims asserted against E&Y Cayman, is of no import. The court is fully capable of applying Cayman Islands law (*Intertec Contracting A/S v Turner Steiner*, 6 AD3d 1, 6 [1st Dept 2004], application of Sri Lankan law does not render New York an inconvenient forum; *Anagnostou, supra,* 204 AD2d at 62, "[T]he courts of New York are frequently called upon to apply the law of foreign jurisdictions").

4. Weighing of Public and Private Factors

As for the private interests of the litigants, E&Y Cayman has not demonstrated how retaining this forum would create hardship to defendants. Rather, dismissing this action in favor of the Cayman Islands as a forum will likely cause more hardship to the parties and witnesses as all parties to the present action are parties to parallel actions pending in the Southern District of New York, discussed above. If plaintiffs were forced to commence this action in the Cayman Islands while the parties are involved in the Investor Actions across the street, the parties would be forced to simultaneously litigate two related actions in two countries, in the Southern District and in the Cayman Islands.

Neither has E&Y Cayman established that litigating this action here would burden New York courts (*Shin-Etsu Chemical Co., Ltd., supra*, 9 AD3d at 175-176). Rather, the State of New York has a recognized interest in maintaining and fostering its "undisputed status as the preeminent commercial and financial

nerve center of the Nation and the world", which necessarily entails providing "ready access to a forum for redress of injuries arising out of transactions spawned here" (*Marine Midland Bank, N.A. v United Missouri Bank, N.A.*, 223 AD2d 119, 123-124 [1st Dept 1996], *lv appeal dismissed* 88 NY2d 1017 [1996]). Moreover, this complex commercial dispute is of the nature frequently resolved by the Commercial Division of this State (*Georgia-Pacific Corp., supra*, 265 AD2d at 112), which was designed to be a "world-class forum for the resolution of business disputes" (*Technology Outsource Solutions, LLC v ENI Technology*, 2003 WL 252141, * 4, quoted Chief Judge Judith Kaye; *American Guarantee and Liability Ins. Co. v Xerox Corp.*, 183 Misc2d 411, 416 [Sup Crt NY County 1999, Ramos, J.], *affd* 270 AD2d 187 [2000]).

Accordingly, E&Y Cayman's motion to dismiss on forum non conveniens grounds is dismissed.

B. Release

E&Y Cayman moves under CPLR 3211 [a][5], on the ground that it has already been released from liability under the retainer agreement executed between E&Y Cayman and the Master Fund.[14]

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[14] Pursuant to the retainer agreement, "The Fund agrees to release and indemnify Ernst & Young [Cayman Islands] and its personnel from any liability and costs relating to the services under this letter attributable to any fraudulent acts or omissions, misrepresentations, or willful default by management and employees" (annexed to E&Y Cayman Notice of Motion at Exh. B).

Here, E&Y Cayman maintains that the parties understood the term "management", as appears in the retainer agreement, to refer to the Master Fund's investment manager, Beacon Hill, while plaintiffs argue that the term "management" refers to the Master Fund's own principals, whose conduct is not at issue in this action. Moreover, plaintiffs argue that the indemnification clause does not serve to release E&Y Cayman from liability because plaintiffs seek to hold it liable based upon its own primary conduct as auditor of the Master Fund.

Here, as indemnity provisions are contracts to be interpreted under contract law, the court applies Cayman Islands law to determine the scope and meaning of the release.[15] According to plaintiffs' Caymanian law expert and absent contradiction from E&Y Cayman, indemnification clauses are to be construed strictly against the party seeking to be indemnified, the language of the clause must be given its ordinary and natural meaning and any ambiguities or doubts are to be resolved against the party seeking to rely on the clause (George Aff., ¶ 10, 11; Sec. Jones Aff., ¶ 2).[16]

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[15] The retainer agreement contains a choice of law provision indicating that Cayman Islands law governs (retainer agreement, ¶ 14). See page eight for a discussion on interpretation of choice of law provisions.

[16] In this regard, Caymanian law is indiscernible from New York law, which interprets releases strictly and according to contract principles (*Wells v Shearson Lehman/American Express, Inc.*, 72 NY2d 11, 19 [1988], *rearg denied* 72 NY2d 953 [1988], "[T]he courts must look to the language of a release - the words used by the parties").

Here, the language of the release does not exculpate E&Y Cayman from liability for its own tortious acts, including professional malpractice, arising out of the allegedly deficient audit it conducted. Moreover, to the extent that E&Y Cayman requests the court to consider extrinsic evidence, including the Master Fund's Articles of Association and the U.S. GAAS, in an attempt to demonstrate that the term "management", as used in the clause, was intended by the parties to refer to Beacon Hill and not to the Master Fund's own managers, E&Y Cayman cites to no Caymanian authority supporting the proposition that extrinsic evidence be considered in the interpretation of a release clause.

Therefore, based upon the Cayman law presented and the language of the indemnification clause itself, the court concludes that E&Y Cayman has not demonstrated that the clause serves to release it from liability for malpractice, the claim for aiding and abetting breach of fiduciary duty, or the costs associated with defending this action, at this time.

C. Professional Malpractice

Plaintiffs' claims for professional malpractice arise out of the allegedly deficient audited statement of the Master Fund's financial reports, and the E&Y Defendants' alleged failure to confirm the valuation model used by Beacon Hill and failure to investigate whether Beacon Hill's values contained misstatements. Although E&Y LLP neither executed any agreement to perform auditing services nor issued the audited financial report on

behalf of the Master Fund, plaintiffs maintain that one of E&Y LLP's junior auditors worked on the audit.

Under New York law,[17] however, while the potential for accountant liability is "carefully circumscribed" in the absence of a contractual relationship between an accountant and the party claiming injury (*Iselin & Co. v Landau*, 71 NY2d 420, 425 [1988]), it is not legally impossible. Rather, in the landmark case of *Credit Alliance Corp v Arthur Anderson*, the Court of Appeals developed an analytic framework to determine whether an accountant may be held liable to a third party claiming injury from an accountant's work in the absence of a contractual relationship (*Credit Alliance Corp v Arthur Anderson*, 65 NY2d 536, 551 [1985]).

The *Credit Alliance* test[18] contemplates the defendant accountant's preparation of an audited financial report and the

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[17] While the retainer agreement with E&Y Cayman calls for the application of Caymanian law to govern the contract, neither party asserts that Caymanian law applies to plaintiffs' tort claims and both parties cite to New York law.

Where the parties' briefs reflect an assumption that one state's law applies, such "implied consent to use a forum's law is sufficient to establish choice of law" (*In the Matter of Tehran-Berkeley Civil*, 888 F2d 239, 242 [2nd Cir 1989]).

The court therefore applies New York law to plaintiffs' tort claims asserted against the E&Y Defendants.

[18] The *Credit Alliance* test requires, "(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; (3) there must have been some conduct on the part of the accountants linking them to that party or parties" (*Id*).

court's inquiry is centered on the extent of contacts between the accountant and the plaintiff such that a plaintiff's reliance on the financial report is reasonable, despite the absence of an agreement (*Id*).

Here, the complaint alleges that while no contractual relationship was ever established between the Master Fund and E&Y LLP for the performance of accounting services, pursuant to an agreement, the Master Fund retained E&Y Cayman to conduct an audit of the Master Fund and the audited financial report was prepared by E&Y Cayman, pursuant to an engagement letter (Complaint, ¶ 45, "In the Master Fund's Engagement Letter, E&Y Cayman expressly committed to conduct the audit in accordance with auditing standards").

The degree of E&Y LLP's assistance is disputed; the complaint alleges that an E&Y LLP junior auditor, Ryder, was the "sole person charged with determining the value of the Master Fund's securities", yet fails to allege facts to establish on what basis Ryder, a junior auditor, became involved with E&Y Cayman's client and rose to become the "sole person" in charge of an audit that E&Y LLP was not contractually bound to conduct.

Plaintiffs point to a 2002 e-mail authored by Beacon Hill Defendant Barry, where he allegedly identifies one of E&Y LLP's resident partners as the "Ernst & Young partner on the account"(Complaint, ¶ 44). According to the complaint, this partner allegedly "pitched the firm's services to Beacon Hill to act as auditor of both Beacon Hill itself and the funds under its

management", but fails to allege what such conduct entailed.

Notwithstanding Barry's alleged representation that an E&Y LLP executive was auditing the Master Fund, plaintiffs themselves allege that it was E&Y Cayman and not E&Y LLP that issued the audited financial report, albeit, with the assistance of E&Y LLP. Plaintiffs do not point to any aspect of the audited financial report or any other work product prepared by E&Y LLP that the Master Fund allegedly relied upon. The applicability of *Credit Alliance* to this claim is therefore limited, as the threshold inquiry under that case's holding is the accountant's preparation of a financial report that is later relied upon by the plaintiff.

Here, in contrast, E&Y LLP allegedly performed some audit work, which E&Y Cayman utilized in its preparation of the audited financial report. No allegation is made that even if work conducted by E&Y LLP was incorporated into the audited financial report, E&Y LLP either authorized it or that it otherwise was foreseeable that such work would be incorporated by E&Y Cayman.

Plaintiffs' reliance on *Ossining Union* for the proposition that the absence of a written agreement does not bar a claim for professional malpractice where the professional assumes a duty towards a plaintiff, is misplaced. There, plaintiff entered in an agreement with defendant architectural firm to conduct an evaluation and feasibility study of plaintiff's buildings, which agreement authorized the architectural firm to retain consultants (*Ossining Union v Anderson*, 73 NY2d 417, 419-420 [1989]). The main issue before the court was whether the consultants retained

by the contractually bound architectural firm could be liable for negligent representations contained in field studies plaintiff relied on, in the absence of a contractual relationship between them.

The court extended the *Credit Alliance* test to claims for negligent misrepresentation and held that its applicability is not limited to the profession of accounting (*Id* at 424). Further, the court sustained plaintiff's claim despite the absence of a contractual relationship based upon the extent of the "direct contact" between plaintiff and the non-contractually bound party, rendering plaintiffs' reliance upon the consultants' studies and reports foreseeable (*Id* at 425).

Here, however, unlike in *Ossining Union* and *Credit Alliance*, there exists no referable, tangible representations created by E&Y LLP, the non-contracting party, that plaintiffs allege reliance upon. It is indisputable that E&Y LLP did not issue the audited financial report, which is the core of plaintiffs' claim for malpractice. Rather, E&Y LLP performed some work that was allegedly utilized by the party with whom the Master Fund contracted, E&Y Cayman, to perform an audit.

In the entire line of *Credit Alliance* cases it is a plaintiff's reliance on the professional's tangible work product containing representations, made pursuant to a contract with another, that triggers the three-pronged *Credit Alliance* inquiry into whether a duty to act with due care should be imposed upon the professional by law in the absence of an agreement (*See*

Glanzer v Shephard, 233 NY 236, 238, 239 [1922, Cardozo, J.], "[T]he plaintiff's *use* of the *certificates* [issued by the weigher-defendants] was not an indirect or collateral consequence of the action of the weighers" and the copy of the certificates was sent to plaintiff by the seller "for the very purpose of inducing action"; *Ossining Union, supra*, 73 NY2d at 424-425, "defendants were aware ... that the *substance of the reports* they furnished would be *transmitted to and relied upon*" by plaintiff; *Credit Alliance, supra*, 65 NY2d at 551, criteria for liability begins with whether there was "awareness that the *reports* were to be *used* for a particular purpose").

Here, E&Y LLP did not issue any financial statement, audit, report, certificate or any other tangible work product that plaintiffs allege was relied upon by the Master Fund or that came into possession of the Master Fund. *Credit Alliance*, therefore, while informative to many issues raised by this claim, is inapplicable in the absence of the non-contractually bound accountant, E&Y LLP, having authored any audited financial report.

More on point to the present action, in *In re AM Intern., Inc. Securities Litigation*, 606 FSupp 600, 606 [SDNY 1985], the court dismissed a claim for aiding and abetting fraud asserted against the plaintiff's independent auditor arising out of alleged misrepresentations and omissions found in uncertified interim financial reports prepared by *another* accountant and upon which the independent auditor did not issue any opinion. The

court stated that liability could not be predicated where the accounting firm specifically did not issue an opinion and in the absence of the violation of an independent duty to act, even amidst allegations that the accountant had "seen or reviewed" some of the reports and "that its main objective" was to retain the plaintiff as a client.

Further, courts in numerous jurisdictions have rejected treating different firms as a single entity for joint and several liability purposes simply because they share an associational name *and* collaborated on certain aspects of the transaction at issue (*See In re AM Intern., Inc. Securities Litigation, supra,* 606 Fsupp at 607, dismissing complaint against Price Waterhouse entities located abroad upon the rejection that all Price Waterhouse entities were "in fact one entity, and acted as agents of one another", despite the allegation that the foreign entities "acted as a source of information" for the U.S. entity where there was no allegation that the foreign firms participated in any decision as to how the information should be reported; *See also In re Royal Ahold N.V. Securities & ERISA Litigation*, 351 FSupp2d 334, 385 [DMD 2004], Netherlands and U.S. Deloitte Touche entities treated as autonomous firms despite allegations that the U.S. entity served as "file reviewer" for the Netherlands firm to ensure that the adapted financial statements conformed to GAAS).

Here, while plaintiffs allege that E&Y LLP performed audit work, amidst the conflicting allegation that only E&Y Cayman issued the audited financial report, if in fact some of E&Y LLP's

work *was* integrated by E&Y Cayman and merged in the audited financial report, there is no allegation that E&Y LLP made any decision as to how the audit should be conducted and what information should be included in the report or even that it had any knowledge that its work would be integrated by E&Y Cayman.

Even under the *Credit Alliance* test, however, plaintiffs do not allege contacts between the Master Fund and E&Y LLP sufficient to establish a relationship "sufficiently approaching privity" (*accord Credit Alliance, supra,* 65 NY2d at 553-554, court declined to extend liability to an accounting firm predicated upon a non-contracting parties' injury where the accountant had not been retained to induce plaintiff to extend the loan, had not specifically agreed to prepare the audit for the plaintiff's use and had not directed any communication towards the plaintiff sufficient to establish any link whatsoever).

Here, the only alleged links between the Master Fund and E&Y LLP is E&Y LLP's executive, Forstenhausler's, pitching the firm's services to Beacon Hill and its funds, including the Master Fund, which is insufficient to establish any links approaching a relationship of privity between the Master Fund and E&Y LLP.

For these reasons, plaintiffs' claim against E&Y LLP fails. Rather, if any duty beyond the duty to perform under contract exists, it is that owed by E&Y Cayman, the entity that actually issued the audited financial report that the Master Fund

allegedly relied upon to its detriment. The motion to dismiss the complaint is granted on the claim for professional malpractice against defendant E&Y LLP.

As for E&Y Cayman's liability for malpractice, it asserts that plaintiffs have failed to allege that the Master Fund's losses were proximately caused by E&Y Cayman's audit. Here, plaintiffs allege that E&Y Cayman was negligent in conducting the audit by failing to corroborate valuations reported by Beacon Hill in its financial statements, which were so blatant that E&Y Cayman should have detected it and alerted the Master Fund to Beacon Hill's manipulative valuations. The timely discovery of Beacon Hill's manipulative valuations allegedly would have avoided the massive trading losses ultimately suffered by the Master Fund, because if alerted, the Master Fund would have terminated Beacon Hill immediately.

According to the Court of Appeals, "the proximate cause of the damages claimed is an issue of fact inappropriate for determination" on a motion to dismiss for failure to state a cause of action, pursuant to CPLR 3211 [a][7] (*EBC I, Inc. v Goldman Sachs & Co.*, 5 NY3d 11, 18 [2005]). Thus, defendants' motion is premature and plaintiffs' allegations of malpractice are sufficient to withstand a motion to dismiss.

D. Aiding and Abetting Breach of Fiduciary Duty

Plaintiffs allege that the E&Y Defendants aided and abetted Beacon Hill's breach of fiduciary duty stemming from the manipulative valuing of the Master Fund's portfolio. As the

court dismissed the primary breach of fiduciary claim as duplicative of the breach of contract claim, no claim for aiding and abetting the breach of such duty can lie (*See Higgins v New York Stock Exchange*, 10 Misc3d 257, 287 [Sup Ct NY County 2005, Ramos J.]). Therefore, the motion to dismiss the claim for aiding and abetting breach of fiduciary duty asserted against the E&Y Defendants is granted as to both parties, and the claim dismissed.

4. Claims Asserted Against ATC

The alleged wrongdoing on the part of ATC involves its failure to verify the accuracy of Beacon Hill's valuations, which it then disseminated in the Master Fund's NAVs. Defendant ATC maintains that collateral estoppel bars plaintiffs' claims.

Under New York law,[19] the doctrine of collateral estoppel precludes a party from re-litigating in a subsequent action an issue necessarily raised and decided against that party or those in privity with that party in a prior action (*Buechel v Bain*, 97 NY2d 295, 302 [2001], *cert denied* 535 US 1096 [2002]). In order to invoke the doctrine's application here, there must be

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[19] While the Administration Agreement executed between the parties contains a choice of law clause, dictating that the agreement be governed and construed in accordance with Caymanian law (Administration Agreement, § 2.14), both parties cite to New York cases in support of their respective positions, only.

Therefore, as discussed above, where the parties' briefs reflect an assumption that one state's law applies, such "implied consent to use a forum's law is sufficient to establish choice of law" (*In the Matter of Tehran-Berkeley Civil, supra*, 888 F2d at 242).

identicality of the issue posed by the plaintiffs in the Investor action and which is decisive of the present action, and plaintiffs must have had a "full and fair opportunity to contest the decision now said to be controlling" (*Id*).

In considering whether re-litigation is appropriate, the doctrine is guided by competing policy considerations, including fairness to the parties, consistent and accurate results and conservation of judicial resources (*Staatsburg Water Co. v Staatsburg Fire Dist.*, 72 NY2d 147, 153 [1988]).

In the first instance, plaintiffs maintain that there is no privity between them and the plaintiffs in the Investor Action, necessarily defeating invocation of collateral estoppel. New York has rejected the notion that literal privity is required between the parties and employs a fluid approach to privity, which turns on a legal determination of whether the parties' relationship is sufficiently close to justify preclusion (*Phillips v Kidder, Peabody & Co.*, 750 FSupp 603, 607 [1990]; *See also Marvel Characters, Inc. v Simon*, 301 F3d 280, 286 [2nd Cir 2002], *cert denied* 543 US 872 [2004], there is no discernible difference between federal and New York law concerning collateral estoppel).

A non-party is considered to be in privity with a party to the prior litigation only if "that non-party was represented by a party to the prior proceeding, or exercised some degree of actual control over the presentation on behalf of a party to that proceeding" (*Stichting v Schreiber*, 327 F3d 173, 185 [2nd Cir

2003], holding that there is privity between party in previous suit and party in current suit when party to previous suit acts as fiduciary of party to the second suit or party to second suit exercises some degree of control over presentation of party's suit at the first suit; *See also Juan C. v Cortines*, 89 NY2d 659, 667 [1997], privity exists between a party and non-party to the prior action where they share a relationship such that "his own rights or obligations in the subsequent proceeding are conditioned in one way or another on, or derivative of, the rights of the party to the prior litigation").

Privity based upon the same representation exists only if "the interests of the person alleged to be in privity were represented in the prior proceeding by another vested with the authority of representation" (*Stichting, supra,* 327 F3d at 185). Such authority of representation exists where the party in the prior suit is acting "either as a fiduciary or organizational agent of the person against whom preclusion is asserted" (*Id*).

Here, plaintiffs, the official liquidators of the Master Fund, were appointed to be fiduciaries of the Master Fund, to oversee the process of winding down of the Master Fund pursuant to Caymanian law. While the Master Fund nor any of the Funds that comprise it are not parties to the Investor action, plaintiffs in that action are thirty-six shareholders and/or limited partners of the Master Fund who invested in one, several or all of the Funds that comprise the Master Fund (*Fraternity*

Fund, supra, 376 FSupp2d at 392).

Plaintiffs here clearly have a corporate relationship with the Master Fund's shareholders and limited partners, who retain ownership interests in the very Funds that plaintiffs are appointed fiduciaries of. In this capacity, plaintiffs in the Investor Actions are akin to "organizational agents" (*Stichting, supra*, 327 F3d at 185; *See Monahan v NYC Dept. of Corrections*, 214 F3d 275, 285 [2nd Cir 2000], holding that union members are bound by a judgment by a judgment in a previous action brought by union president in his capacity as president, notwithstanding that union members were not a party to the original lawsuit).

Neither can it be said that barring plaintiffs from re-litigating here disturbs notions of due process which underpin any court's analysis of collateral estoppel (*Id*). It is undisputed that plaintiffs here had notice of the Investor Action as parties in both actions are represented by the same counsel. While identical counsel in two actions is not a determinative factor, it bolsters the finding of "practical control" over the prior litigation such that the interests represented are said to be identical (*Conte v Justice*, 996 F2d 1398, 1402-1403 [2nd Cir 1993], applying New York law; *but see Green v Sante Fe Indus. Inc.*, 70 NY2d 244, 254 [1987]). Thus, the court finds that the Master Fund's relationship to the plaintiffs in the Investor Action is sufficiently close such that privity between them is established.

As for the identicality of issues, the burden is on the

party asserting collateral estoppel to demonstrate that the issue in the present litigation is identical to the issue raised in the prior action, and that determination of that issue was decisive to the outcome of the prior action and would be decisive of the present action (*Juan C., supra*, 89 NY2d at 667).

In the Investor Action, the court considered a federal securities law claim against ATC, predicated upon ATC's failure to independently verify the accuracy of valuations supplied by Beacon Hill and the incorporation of these values in its NAVs (*Fraternity Fund, Ltd. v Beacon Hill Asset Management LLC et al*, 376 FSupp2d 443, 444 [SDNY 2005]). In dismissing the claim based upon failure to allege facts giving rise to scienter, the court held that plaintiffs in that action mistakenly assumed that ATC had a duty to conduct an independent valuation of the Mater Fund's portfolio, as no such duty existed (*Id* at 447, "Although ATC was allegedly responsible for computing the NAV of the [Master] Funds, that task is different from the task of valuing the securities in the Fund's portfolios", and cites to the Administration Agreement).

This court finds that the issues in both actions as relates to ATC's *contractual* duties under the Administration Agreement are identical, which justifies invocation of collateral estoppel barring re-litigation of plaintiffs' breach of contract claim. Identicality is established as any analysis undertaken by the court would necessarily begin with whether ATC had a contractual duty under the Administration Agreement obligating it to

independently verify Beacon Hill's values.

The issues are not substantially similar as to the remaining claims asserted against ATC, for breach of fiduciary duty and for aiding and abetting breach of fiduciary duty, however.

Plaintiffs' claim sounding in breach of fiduciary duty is duplicative of its breach of contract claim (*Sergeants Benev. Ass'n. Annuity Fund, supra,* 19 AD3d at 118), and is therefore dismissed.

As for the claim for aiding and abetting breach of fiduciary duty arising out of Beacon Hill's breaches in manipulating the Master Fund's values, the primary claim for breach of fiduciary duty was dismissed and thus this claim cannot lie.

Therefore, the motion to dismiss the complaint as to the claims asserted against ATC is granted and all claims dismissed. Accordingly, it is

ORDERED that the motion to dismiss the complaint is denied as to the first cause of action for professional malpractice asserted against E&Y Cayman, the fourth cause of action for breach of contract asserted against Beacon Hill, and the tenth cause of action for breach of the fiduciary duty of self-dealing against the Beacon Hill Defendants Irwin, Daniels and Barry; and it is further

ORDERED that the motion is otherwise granted and claims two, three, five, six, seven, eight, nine, and ten as to Beacon Hill defendant Miszkiewicz only are dismissed and severed from this

action.

Dated: April 12, 2006

J.S.C.

CHARLES E. RAMOS

Counsel are hereby directed to obtain an accurate copy of this Court's opinion from the record room and not to rely on decisions obtained from the internet which have been altered in the scanning process.