

First Cent. Sav. Bank v Parentebeard, LLC
2015 NY Slip Op 31921(U)
October 13, 2015
Supreme Court, New York County
Docket Number: 653680/2014
Judge: Shirley Werner Kornreich
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SHIRLEY WERNER KORNREICH**J.S.C.**SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 54

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 FIRST CENTRAL SAVINGS BANK, JOSEPH PISTILLI,
 JAMIE PISTILLI, ANTHONY PISTILLI, DONNA
 PISTILLI, DANIEL BENEDICT, REENA BENEDICT,
 DONALD A. CORDANO, ANDREW C. PRESTI,
 EILEEN PRESTI, SPIRO KONSTANTINIDES, as
 Trustee of the Savas Konstantinides 2012 Family Trust, as
 Successor in interest to Savas & Sophia Konstantinides,
 and ANDREW LATOS,

Index No.: 653680/2014

DECISION & ORDER

Plaintiffs,

-against-

PARENTEBEARD, LLC and BAKER TILLY VIRCHOW
 KRAUSE, LLP,

Defendants.

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 SHIRLEY WERNER KORNREICH, J.:

Defendants ParenteBeard LLC (Parente) and Baker Tilly Virchow Krause, LLP (Baker) move, pursuant to CPLR 3211, to dismiss the complaint. Defendants' motion is granted in part and denied in part for the reasons that follow.

I. Procedural History & Factual Background

As this is a motion to dismiss, the facts recited are taken from the complaint and the documentary evidence submitted by the parties.

Plaintiff First Central Savings Bank (the Bank) is a New York State chartered savings bank. Complaint ¶ 1. The other named plaintiffs are shareholders of the Bank (the Shareholder Plaintiffs). ¶ 23. At the time of the underlying events, six of the Shareholder Plaintiffs – Daniel Benedict, Anthony Pistilli, Joseph Pistilli, Andrew C. Presti, and Donald A. Cordano – were members of the Bank's Board of Directors (the Board). *Id.* Parente and Baker are accounting firms. ¶¶ 9-10. As discussed below, this action concerns accounting, auditing, and tax services Parente provided to the Bank. Plaintiffs allege that on October 1, 2014, Parente and Baker

merged and now collectively do business under the name “Baker Tilly Virchow Krause, LLP.” ¶ 11.

The Bank conducts business on a fiscal year ending September 30. ¶ 16. For the fiscal year ending on September 30, 2010, the Bank was required to file its federal, state, and local tax returns by December 15, 2010. *Id.* The Bank alleges that “Parente agreed to file extensions with the various taxing authorities, which permitted [the Bank] to file its tax returns for the fiscal year ending September 30, 2010 on June 15, 2011.” ¶ 17. The Bank further alleges that “[o]n or about December 15, 2010, Parente advised [the Bank] that it had electronically filed IRS form 7004, Application for Automatic Extension of Time To File Certain Business Income Tax, Information, and Other Returns (“Form 7004”), with the Internal Revenue Service [the IRS] timely, thereby extending [the Bank’s] date to file its tax returns until June 15, 2011.” ¶ 18.

Approximately five months later, the Bank engaged Parente to file its federal, state, and local tax returns for the fiscal year ending September 30, 2010. ¶ 19. Parente’s engagement is governed by a letter agreement dated May 2, 2011 (the Agreement). *See* Dkt. 9. The Agreement provides that the engagement is limited to the preparation and filing of the delineated 2010 tax returns, and in consideration for such services, the Bank agreed to pay Parente a fee of \$7,000. *See id.* at 3. The Agreement is clear that “[Parente’s] work in connection with the preparation of [the Bank’s] corporate income tax returns does not include any procedures designed to discover fraud, defalcations, or other irregularities, should any exist” and that Parente was “undertaking this engagement based on [the Bank’s] express agreement that [the Bank is] **releasing** [Parente] from any liability for failure to detect fraud.” *See id.* (emphasis added). The Agreement further provides:

In recognition of the relative risks and benefits of this agreement to both [the Bank and Parente], [the Bank and Parente] have discussed and agreed on the fair

allocation of risk between them. As such, [the Bank] agrees, to the fullest extent permitted by law, to limit the liability of [Parente to the Bank] for any and all claims, losses, costs, and damages of any nature whatsoever, so that the total aggregate liability of [Parente to the Bank] shall not exceed [Parente's] total fee for Services rendered pursuant to this agreement [i.e., \$7,000]. [The Bank and Parente] intend and agree that this limitation apply to any and all liability or cause of action against [Parente], however alleged or arising, unless otherwise prohibited by law.

See id.

Additionally, attached to the Agreement are "Additional Terms and Conditions." *See id.*

at 5-8. Condition 8 states:

Neither [the Bank or Parente] will, in any event, be liable to the other, for any reason, for any consequential, incidental, special, punitive, or indirect damages, including loss of profits, revenue, data, use of money or business opportunities, regardless of whether notice has been given or there is an awareness that such damages have been or may be incurred.

See id. at 6.

Pursuant to the Agreement, Parente prepared and filed the Bank's 2010 federal tax return.¹ Complaint ¶ 19. The IRS, however, rejected the tax return as untimely because it had no record of a Form 7004 being filed on the Bank's behalf. *Id.* As a result of the late filing, the IRS disallowed the Bank's right to carry-back \$2,514,143 of net operating losses (the Tax Benefit). ¶ 20. Though the Tax Benefit was disallowed by the IRS, it was nonetheless included on a September 30, 2010 financial statement issue by Parente (the Financial Statement). ¶ 21. The complaint, however, does not state when Parente prepared or issued the Financial Statement or whether it was prepared pursuant to the Agreement or as part of a separate engagement.²

¹ Presumably, this was done before June 15, 2011, but the complaint does not say so.

² At oral argument, plaintiffs' counsel clarified some of the numerous ambiguities in the complaint, such as the fact that the Financial Statement was prepared prior to the execution of the Agreement. *See* Dkt. 22 (6/4/15 Tr. at 22). Since the briefing did not address these

Following the issuance of the Financial Statement, the Bank conducted a Preemptive Rights Offering (the PRO) to sell stock to its existing shareholders. ¶ 24. The Bank alleges that an Offering Circular was prepared in connection with the PRO for the purpose of providing the Bank's shareholders with the business and financial information necessary to make an informed decision on whether to purchase additional shares at a price of \$7 per share. *Id.* The Financial Statement was included in the Offering Circular. Plaintiffs allege that "Parente drafted[,] reviewed and/or edited the Offering Circular" and that Parente knew the Offering Circular was intended to be forwarded to the Shareholder Plaintiffs. ¶ 27. The Shareholder Plaintiffs allege they relied on the Financial Statement in deciding whether to purchase additional stock at the offering price of \$7.³ ¶ 26. Plaintiffs allege that the "Financial Statement was also sent by Parente to the [Shareholder Plaintiffs] as members of [the Bank's] Audit Committee to be distributed directly to [the Bank's] Board Members." ¶ 29.⁴

Plaintiffs commenced this action on November 26, 2014. The Bank seeks to hold Parente liable for causing losses flowing from the Tax Benefit being disallowed due to Parente's failure to file the Form 7004. The Shareholder Plaintiffs seek to hold Parente liable for inducing them to purchase shares in the PRO at a price based on the Bank's worth as represented in the Financial Statement, which did not account for disallowance of the Tax Benefit. The Shareholder Plaintiffs aver that had they known the Tax Benefit would be disallowed, they would not have purchased at an inflated \$7 per share. The Complaint asserts four causes of

clarifications, the court will not discuss them. Rather, as plaintiffs are being granted leave to amend, the court reserves judgment on such allegations until they are properly before the court.

³ See Complaint ¶¶ 54-60 (setting forth how many shares were purchased by each of the Shareholder Plaintiffs in the PRO).

⁴ Parente sent the Financial Statement directly to the Shareholder Plaintiffs, who were both shareholders and board members.

action, numbered here as in the complaint: (1) negligence and professional malpractice, asserted by the Bank, for Parente's failure to file the Form 7004; (2) gross negligence, asserted by the Bank, for Parente's failure to file the Form 7004; (3) negligence and professional malpractice, asserted by the Bank, for Parente's preparation of the inaccurate Financial Statement; and (4) negligent misrepresentation, asserted by the Shareholder Plaintiffs, based on their reliance on the Financial Statement in connection with the PRO.

On January 20, 2015, defendants moved to dismiss, arguing: (1) the Bank's negligence and malpractice claims are barred by the Agreement's limitation of liability clauses; (2) the Bank's cause of action for Parente's preparation of an inaccurate Financial Statement should be dismissed for failure to plead damages; (3) the Bank has not properly pleaded a claim for gross negligence; (4) the Shareholder Plaintiffs' negligent misrepresentation claims should be dismissed for failure to sufficiently plead near privity; and (5) plaintiffs have no basis to demand attorneys' fees.

II. Legal Standard

On a motion to dismiss, the court must accept as true the facts alleged in the complaint as well as all reasonable inferences that may be gleaned from those facts. *Amaro v Gani Realty Corp.*, 60 AD3d 491 (1st Dept 2009); *Skillgames, LLC v Brody*, 1 AD3d 247, 250 (1st Dept 2003), citing *McGill v Parker*, 179 AD2d 98, 105 (1992); *see also Cron v Harago Fabrics*, 91 NY2d 362, 366 (1998). The court is not permitted to assess the merits of the complaint or any of its factual allegations, but may only determine if, assuming the truth of the facts alleged and the inferences that can be drawn from them, the complaint states the elements of a legally cognizable cause of action. *Skillgames, id.*, citing *Guggenheimer v Ginzburg*, 43 NY2d 268, 275 (1977). Deficiencies in the complaint may be remedied by affidavits submitted by the plaintiff. *Amaro*,

60 NY3d at 491. “However, factual allegations that do not state a viable cause of action, that consist of bare legal conclusions, or that are inherently incredible or clearly contradicted by documentary evidence are not entitled to such consideration.” *Skillgames*, 1 AD3d at 250, citing *Caniglia v Chicago Tribune-New York News Syndicate*, 204 AD2d 233 (1st Dept 1994). Further, where the defendant seeks to dismiss the complaint based upon documentary evidence, the motion will succeed only if “the documentary evidence utterly refutes plaintiff’s factual allegations, conclusively establishing a defense as a matter of law.” *Goshen v Mutual Life Ins. Co. of N.Y.*, 98 NY2d 314, 326 (2002) (citation omitted); *Leon v Martinez*, 84 NY2d 83, 88 (1994).

III. Discussion

A. Limitation of Liability Clauses

Parente argues that even if its liability is established, liability is capped at the \$7,000 fee amount set forth in the Agreement. *See* Dkt. 9 at 3. Parente further argues that to the extent the complaint seeks consequential damages, such damages are also expressly precluded by the Agreement. *See id.*

With respect to the Bank’s first cause of action relating to Parente’s failure to file the Form 7004, the limitation of liability clauses do not apply because the Bank is not asserting a claim for negligently preparing its 2010 federal tax return. The Bank does not claim that the substance of the 2010 return was improper. Rather, the Bank claims that Parente previously failed to timely file the Form 7004, and as a result, the IRS disallowed the Tax Benefit. The disallowance was not the result of a negligently prepared return. Consequently, the Bank’s claim does not arise from the engagement governed by the Agreement, which was strictly limited to

preparation of the Bank's 2010 tax returns. Instead, the Bank's claim arises from Parente's alleged negligence committed five months prior to the engagement.

Nowhere in the Agreement is there anything that states, as is common in contracts that purport to release all known and unknown claims between parties, that the Agreement releases or limits Parente's liability for matters beyond the scope of the retention for the preparation of the Bank's 2010 tax returns. Nor does the Agreement purport to waive or release claims for all wrongdoing that already occurred. Parente clearly understood the distinction between a retrospective release of claims and a prospective limitation of liability, as the Agreement separately provides that the Bank "is **releasing** [Parente] from any liability for failure to detect fraud." *See* Dkt. 9 at 3 (emphasis added). The failure to detect fraud is a wrong distinct from the mere negligent preparation of a tax return. Had Parente sought an express release for any other actions taken prior to the preparation of Parente's 2010 returns, or indeed a release for all actions prior to the engagement, it could have so provided. Hence, the court rejects Parente's argument that its liability for negligence committed with respect to its failure to file the Form 7004 is limited to \$7,000.

The same cannot necessarily be said, however, with respect to the Bank's third cause of action for negligent preparation of the Financial Statement. The complaint is unclear as to when it was prepared, for what purpose, and what engagement agreement (if any) governs its preparation.⁵ As with the 2010 federal tax return, the Financial Statement itself is not alleged to have been inaccurate, at least not to the extent that any of the Bank's reported financial information is incorrect (e.g., overstating accounts receivable). Rather, the Financial Statement

⁵ As noted earlier, at oral argument, for the first time, plaintiffs clarified that the Financial Statement was prepared prior to the retention on May 2, 2011. As further noted herein, the circumstances of Parente's involvement with the PRO are still not clear.

appears to have been prepared under the assumption that the Tax Benefit claimed in the tax return would be allowed. It was not. This occurred after the Financial Statement was issued. Regardless, as explained below, the complaint does not allege that the Bank itself (as opposed to its shareholders) suffered damages by virtue of the Financial Statement inaccurately reporting the Tax Benefit. The court, therefore, does not reach the issue of what limitation of liability might apply to this claim.

B. Failure to Plead Damages

Parente argues that the Bank's third cause of action for negligence with respect to the Financial Statement should be dismissed for failure to plead damages. Parente argues that the Bank, unlike its shareholders, did not suffer a loss due to the inclusion of the Tax Benefit in the Financial Statement. In other words, it was the Shareholder Plaintiffs who allegedly were harmed, not the Bank. Parente contends the Bank actually benefited, since the Tax Benefit supported a higher price in the PRO than it would have obtained without accounting for the Tax Benefit, which resulted in the Bank receiving more money from the Shareholder Plaintiffs.

The Bank does not address this argument. In conclusory fashion, the complaint merely claims the Bank suffered compensable damages.⁶ Dismissal, therefore, is warranted. *See Russo v Rozenholc*, 130 AD3d 492, 496-97 (1st Dept 2015) (A viable malpractice claim requires the complaint to allege that "the negligence was the proximate cause of the loss sustained; **and actual damages**") (emphasis added), quoting *O'Callaghan v Brunelle*, 84 AD3d 581, 582 (1st Dept 2011); *see also Eighth Ave. Garage Corp. v Kaye Scholer LLP*, 93 AD3d 611, 612 (1st Dept 2012) (complaint dismissed where "Plaintiffs failed to allege facts in support of their claim

⁶ In its brief, the Bank suggests that it incurred expenses to prepare a new financials. Such an allegation made by counsel in a brief (as opposed to a sworn affidavit from someone with personal knowledge) is no substitute for actually pleading damages in the complaint.

of [] malpractice that ‘permit the inference that, but for defendants’ [alleged negligence], [they] would not have sustained actual, ascertainable damages.’”), quoting *Pyne v Block & Assocs.*, 305 AD2d 213 (1st Dept 2003). The third cause of action, therefore, is dismissed with leave to replead if plaintiffs can allege facts supporting a reasonable inference that the Bank, as opposed to the shareholders, suffered actual damages.

C. Gross Negligence

Plaintiffs allege that Parente’s failure to file the Form 7004 constitutes gross negligence. “[G]ross negligence’ differs in kind, not only degree, from claims of ordinary negligence. It is conduct that evinces a reckless disregard for the rights of others or ‘smacks’ of intentional wrongdoing.” *Colnaghi, U.S.A., Ltd. v Jewelers Protection Servs., Ltd.*, 81 NY2d 821, 823-24 (1993), quoting *Sommer v Fed. Signal Corp.*, 79 NY2d 540, 554 (1992); see *Pegasus Aviation I, Inc. v Varig Logistica S.A.*, 118 AD3d 428, 433 (1st Dept 2014), citing *Hartford Ins. Co. v Holmes Protection Group*, 250 AD2d 526, 527 (1st Dept 1998) (same). Through a gross negligence claim, plaintiffs seek to vitiate the Agreement’s limitation of liability clauses to recover greater damages. See *Pacnet Network Ltd. v KDDI Corp.*, 78 AD3d 478, 480 (1st Dept 2010) (“Contractual limitation of liability provisions are generally enforceable unless the party seeking to avoid liability has engaged in grossly negligent conduct”), citing *Colnaghi*, 81 NY2d at 823-24 (“Public policy ... forbids a party’s attempt to escape liability, through a contractual clause, for damages occasioned by ‘grossly negligent conduct.’”).

Parente argues that the gross negligence claim should be dismissed because it is conclusorily pleaded. Parente is correct. The only wrongdoing alleged is the negligent failure to file the Form 7004. Plaintiffs do not allege this was done deliberately. Plaintiffs themselves suggest that Parente’s technical misunderstanding of the IRS’s online filing system was the

culprit. Though plaintiffs claim Parente should have known that no filing occurred because it did not receive an electronic filing receipt, this is merely an allegation of negligence. While plaintiffs claim, again in conclusory fashion, that this was a “gross failure to investigate the obvious”, plaintiffs do not explain why this is so. Moreover, the cases of gross negligence cited by plaintiffs do not resemble the facts alleged here. Those cases involve, for instance, accountants recklessly disregarding red flags of fraud. *See* Dkt. 20 at 13-14 (distinguishing cases, involving far more severe allegations); *see, e.g., DaPuzzo v Reznick Fedder & Silverman*, 14 AD3d 302, 303 (1st Dept 2005) (“the complaint adequately alleged facts supporting an inference of fraud based on reckless disregard or blindness to the true nature of the client’s financial condition” because plaintiff alleged “that defendant ignored and failed to report the client’s lack of internal controls, blindly accepted information provided to the client’s Chief Financial Officer without independent verification, and gave in to the CFO’s demands to fix the financial reports to represent a more favorable financial position in order not to jeopardize its fee”). Simply put, the cases cited by plaintiffs do not merely involve an alleged technical oversight, albeit one with costly implications. The dismissal of this claim, as with all other claims dismissed herein, is without prejudice and may be repleaded if plaintiffs can properly allege gross negligence in non-conclusory fashion.

D. Near Privity

The Shareholder Plaintiffs’ claim for negligent misrepresentation is a claim for malpractice asserted by parties not in privity with the accountant. It is undisputed that Parente was the accountant and the Bank was the client. The Shareholder Plaintiffs, therefore, must demonstrate near privity and the requisite linking conduct:

Before accountants may be held liable in negligence to noncontractual parties who rely to their detriment on inaccurate financial reports, certain prerequisites

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

Credit Alliance Corp. v Arthur Andersen & Co., 65 NY2d 536, 551 (1985); *see Secs. Investor Prot. Corp. v BDO Seidman, L.L.P.*, 95 NY2d 702, 711 (2001); *Houbigant, Inc. v Deloitte & Touche LLP*, 303 AD2d 92, 94 (1st Dept 2003); *see also CRT Investments, Ltd. v Merkin*, 29 Misc3d 1218(A), at *12-13 (Sup Ct, NY County 2010) (Lowe, J.) (collecting cases discussing linking conduct), *aff'd sub nom. CRT Investments, Ltd. v BDO Seidman, LLP*, 85 AD3d 470, 472 (1st Dept 2011) ("The fact that plaintiffs were entitled to and received a copy of the audited financial statements, or that [the auditor] knew that the investors would rely upon the information contained in the financial statements, does not establish the requisite linking conduct").

Here, the Shareholder Plaintiffs claim the requisite linking conduct is present based on their allegations that Parente knew the Financial Statement was going to be included in the Offering Circular and would be considered by the Shareholder Plaintiffs in connection with the PRO. The Shareholder Plaintiffs further allege that the Financial Statement was provided directly to them, albeit in their capacity as board members, not shareholders. The Shareholder Plaintiffs argue this distinction does not matter since the Bank, unlike a large, publicly traded company, only has a discreet set of shareholders. Parente disagrees, arguing the claim is insufficiently pleaded.

Although the complaint alleges that the Financial Statement was provided to the Shareholder Plaintiffs, as Parente correctly avers, the complaint does not clearly set forth

Parente's involvement with the PRO. As with the preparation of the Financial Statement, the complaint does not explain Parente's role with respect to the PRO or the timing of the events. Certainly, the Bank, its board and its shareholders are privy to this information. The complaint merely alleges that the failure to file the Form 7004 was further compounded when the assumption of the validity of the Tax Benefit was built into the Shareholder Plaintiffs' evaluation of the Bank's share price through its review of the Financial Statement contained in the Offering Circular. As alleged, the complaint fails to plead a malpractice claim based on near privity. Leave is granted to the Shareholder Plaintiffs to properly replead.

E. Attorneys' Fees

Finally, plaintiffs' attorneys' fees demand is stricken. There is no applicable contractual or statutory provision permitting an attorneys' fees award. *See Gotham Partners, L.P. v High River Ltd. Partnership*, 76 AD3d 203, 206 (1st Dept 2010), citing *U.S. Underwriters Ins. Co. v City Club Hotel, LLC*, 3 NY3d 592, 597 (2004). Nor does any claim surviving dismissal on this motion warrant attorneys' fees. Accordingly, it is

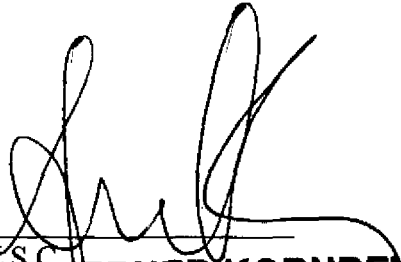
ORDERED that the motion to dismiss the complaint by defendants ParenteBeard LLC and Baker Tilly Virchow Krause, LLP is granted as follows: the second, third, and fourth causes of action are dismissed without prejudice and with leave to replead in accordance with this decision; (2) plaintiffs' attorneys' fees demand is stricken; and (3) the motion is otherwise denied; and it is further

ORDERED that if plaintiffs wish to file an amended complaint, they shall do so within 21 days of the entry of this order on the NYSCEF system, and defendants shall answer the complaint or, if an amended complaint is filed, shall answer or move to dismiss the amended complaint within 21 days, and it is further

ORDERED that the parties are to appear in Part 54, Supreme Court, New York County,
60 Centre Street, Room 228, New York, NY, for a preliminary conference on December 1, 2015
at 10:30 in the forenoon.

Dated: October 13, 2015

ENTER:



SHIRLEY WERNER KORNREICH
J.S.C.