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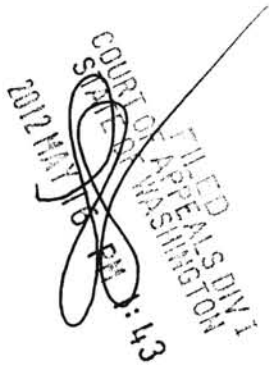
NO. 68130-3-I

IN THE COURT OF APPEALS
OF THE STATE OF WASHINGTON
DIVISION I



FUTURESELECT PORTFOLIO MANAGEMENT, INC., FUTURESELECT PRIME ADVISOR II LLC, THE MERRIWELL FUND, L.P., AND TELESIS IIW, LLC,

Plaintiffs/Appellants,

v.

TREMONT GROUP HOLDING, INC., TREMONT PARTNERS, INC., OPPENHEIMER ACQUISITION CORPORATION, MASSACHUSETTS MUTUAL LIFE INSURANCE CO., and ERNST & YOUNG LLP,

Defendants/Respondents.

BRIEF OF RESPONDENT ERNST & YOUNG

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place of the alleged conduct, residence of the defendants, and center of the parties' relationship—all favor New York. Under New York law, FutureSelect fails to state a claim both because New York's three-year statute of limitations bars its claims and because it fails to satisfy New York's "near-privity" requirement for negligent misrepresentation claims against an auditor. Further, FutureSelect has no basis for statutory claims under New York law.

Second, even if Washington law applies, as FutureSelect argues, its claims also fail. The Washington Supreme Court holds that professionals such as EY must do "something more" than render "routine professional services" to face liability as a "seller" under the WSSA. *Hines v. Data Line Sys., Inc.*, 114 Wn.2d 127, 149–50, 787 P.2d 8 (1990). Because FutureSelect alleges only that EY did the routine work of an auditor (i.e., audit its client's financial statements and issue audit opinions), it has not stated a claim for seller liability under WSSA. Further, the Washington Supreme Court "limits the class of persons who can bring negligent misrepresentation claims" to those who rely on misinformation "in a transaction that [defendant] intends the information to influence or knows that the recipient so intends." *Esca Corp. v. KPMG Peat Marwick*, 135 Wn.2d 820, 832, 959 P.2d 651 (1998). But FutureSelect's Complaint makes clear it bought shares in the Rye Funds ***before*** EY became auditor for the Funds. Because FutureSelect alleges no facts to support a claim that EY intended its audit reports to influence

FutureSelect to buy more shares in the Rye Funds, it has not stated a negligent misrepresentation claim.

II. STATEMENT OF THE CASE

A. FutureSelect Visited New York and Invested in New York Funds Managed by a New York Company.

Plaintiffs FutureSelect Prime Advisor II, LLC, the Merriwell Fund, L.P., and Telesis IIW, LLC, are all investment funds organized under Delaware law. CP 5-6 ¶¶ 15–18. Plaintiff FutureSelect Portfolio Management, Inc., also a Delaware company, manages these investment funds. CP 5 ¶ 15. Although these Delaware entities all allege they have their principal place of business in Washington, CP 5-6 ¶¶ 16-18, the Complaint does not allege that ***any*** defendant is incorporated or has its principal place of business in Washington. *See* CP 6-8 ¶¶ 19–28. In fact, "EY is a Delaware limited liability partnership headquartered in New York City, New York." CP 87-88 ¶ 2.[1]

Bernard Madoff promoted his Ponzi scheme in part by dealing only with select firms and individuals; he would not deal directly with all investors who wanted to share in his claimed investment returns. *See* CP 9 ¶ 32. FutureSelect alleges that it invested in the Rye Funds in 1998 to gain access to Madoff as an investment adviser. CP 9-11 ¶¶ 34–39. It

[1] EY submitted the Zweifach Declaration to support its motion to stay in deference to proceedings related to Tremont and the Rye Funds then pending in New York, on which the trial court properly considered matters outside the record. *See* CP 87-88 ¶¶ 1-2. FutureSelect did not object to the consideration of that Declaration for purposes of establishing undisputed facts relevant to choice of law, such as the states in which EY is registered and has its headquarters.

made those investments through defendants Tremont Group Holdings, Inc., and Tremont Partners, Inc. ("Tremont"), and other funds that invested with Madoff. CP 3, 9-11 ¶¶ 6, 34–39. The Tremont-managed funds in which FutureSelect invested were the Rye Select Broad Market Fund, L.P., the Rye Select Broad Market Prime Fund, L.P., and the Rye Select Broad Market XL Fund, L.P (the "Rye Funds"). *See* CP 3, 6, 9-11 ¶¶ 6, 20, 34–35. At the time, Goldstein Golub Kessler LLP ("GGK") was the Rye Funds' auditor. CP 10 ¶ 36.

FutureSelect began its relationship with Tremont by investing in the Rye Funds in 1998 after FutureSelect's principal, Ronald Ward, travelled to New York to visit Tremont at its New York offices. CP 9-10 ¶¶ 34-37. Throughout FutureSelect's relationship with Tremont, Mr. Ward "regularly" travelled to New York to visit Tremont and discuss FutureSelect's investments in the Rye Funds. CP 11 ¶ 39. In 2000, Mr. Ward visited Tremont in New York to discuss FutureSelect's decision to invest with Madoff and the SEC review of his investments. *Id.* In 2002, Mr. Ward visited Tremont in New York to discuss Madoff's operations and FutureSelect's investments. *Id.* In 2003, Mr. Ward again travelled to New York to visit Tremont and discuss FutureSelect's desire to invest in additional Tremont funds. *Id.* Mr. Ward also had "monthly ongoing communications" with Tremont, a New York company, about Madoff and the performance of the Rye Funds. CP 10-11¶ 38.

By contrast, FutureSelect does not allege EY ever visited Washington in connection with FutureSelect's investments—or in connection with EY's audits of the Rye Funds.

B. After FutureSelect Invested with Madoff, Tremont Engaged EY to Audit Two of the Rye Funds.

EY had nothing to do with FutureSelect's decision to invest with Madoff—or the Rye Funds. When FutureSelect began investing in the Rye Funds in 1998, GGK was the auditor for the Rye Funds. CP 4, 8, 10 ¶¶ 11, 27, 36–37. EY did not become the auditor of any Rye Fund until 2000. CP 8 ¶ 27. And even then, Tremont engaged EY to audit only two Rye Funds: the Rye Select Broad Market Fund, L.P., and the Rye Select Broad Market Prime Fund, L.P. CP 23 ¶ 88. EY's role as auditor of these two Rye Funds lasted only three years, ending in 2003. CP 8 ¶ 27.

EY never had a contractual or other relationship with FutureSelect. Tremont, not FutureSelect, engaged EY to audit the Rye Broad Market and the Rye Broad Market Prime Funds. CP 20 ¶ 77. As auditor, EY had the responsibility only to express an opinion on the annual financial statements of the Rye Funds prepared by their management, i.e., Tremont. *See* Auditing Standards, AU § 110.03 ("The financial statements are management's responsibility.").

C. FutureSelect Sues in Washington.

On August 26, 2010, nearly two years after Madoff's well-publicized fraud came to light, FutureSelect sued seven defendants in King County Superior Court: Tremont Group Holdings, Inc.; Tremont

Partners, Inc.; Oppenheimer Acquisition Corp.; Massachusetts Mutual Life Insurance Company; Goldstein Golub Kessler LLP ("GGK"); KPMG LLP ("KPMG"); and EY. CP 1. FutureSelect alleged EY made false and misleading statements in issuing audit reports on the two Rye Funds from 2000 to 2003. CP 22-23 ¶¶ 87–88. Based solely on its allegations that the audit reports were "addressed" to the "Partners" of the Rye Funds, and that Prime Advisor II, the Merriwell Fund, and Telesis IIW were among the many partners in the funds, FutureSelect alleged EY "knew Plaintiffs were receiving and relying on its audits"—even though it did not (and could not) allege EY sent or delivered the audit reports to FutureSelect. CP 23 ¶ 89; *see* CP 8, 20, 30 ¶¶ 27, 77, 119.

According to FutureSelect, EY as part of its standard audit procedure requested from the "partners" of the fund confirmation of their investments. CP 23 ¶ 89. But FutureSelect did ***not*** allege EY ever sent anything directly to FutureSelect in Washington. (Indeed, FutureSelect did not allege it communicated with EY at all regarding the audit reports or its decision to invest in the Rye Funds.) And although FutureSelect asserted Tremont used EY's audit reports to solicit investors in the Rye Funds, purportedly with EY's "consent and knowledge," CP 20 ¶ 77, FutureSelect did not allege EY itself ever solicited or encouraged investment in the Rye Funds.

Based on these allegations, FutureSelect asserted claims against EY for violation of the Washington State Securities Act ("WSSA") and negligent misrepresentation. CP 36-38, 45-46 ¶¶ 144–51, 201–08.

D. The Trial Court Dismisses for Failure to State a Claim.

Six of the seven defendants—including EY—moved to dismiss for failure to state a claim, CP 56-58, 530-556, 834-859, 860-888, 893-919, while defendant KMPG moved to compel arbitration, CP 569-594. (Before disposition of its motion to dismiss, GGK settled with FutureSelect, leaving six defendants. CP 3292-3322.) On June 3, 2012, after extensive briefing and three oral arguments, the trial court granted defendants' motions in all respects, compelling FutureSelect to arbitrate its claims against KPMG and dismissing FutureSelect's claims against the other five defendants, including EY. CP 3343-3359.

III. ARGUMENT

"If the judgment of the trial court can be sustained upon any ground, whether [it is based on] the grounds stated by the trial court or not," this Court must affirm. *State v. Morales*, 173 Wn.2d 560, 580, 269 P.3d 263 (2012) (quoting *State v. Carroll*, 81 Wn.2d 95, 101, 500 P.2d 115 (1972)). Here, EY moved to dismiss under both Washington and New York law, and the trial court did not specify which law it applied in dismissing FutureSelect's claims. EY believes that New York law should govern, and FutureSelect plainly fails to state a claim under New York

law. But even if this Court holds Washington law controls, FutureSelect fails to state a claim. This Court should affirm under either state's laws.

A. The Court Should Affirm Because New York Law Requires Dismissal of FutureSelect's Claims.

1. New York Law Governs.

To determine choice of law, "Washington has adopted the 'most significant relationship' test as set out in the Restatement (Second) of Conflict of Laws ***§ 145***." *Rice v. Dow Chem. Co.*, 124 Wn.2d 205, 213, 875 P.2d 1213 (1994) (emphasis added). FutureSelect, however, ignores Restatement § 145, citing it only in passing in a parenthetical. *See* Br. at 18. Rather than apply the governing test, FutureSelect cherry-picks a few factors from a different test in Restatement § 148 (not § 145) to support its choice of law analysis.[2] Br. at 18–19. But the Washington Supreme Court ***declined*** to adopt Section 148 in tort cases. Instead, "the general principles enunciated in the Restatement (Second) of Conflict of Laws § 6 and §***145*** … apply in actions ***sounding in tort*** that involve choice of law issues." *Southwell v. Widing Transp.*, 101 Wn.2d 200, 204, 676 P.2d 477 (1984) (emphasis added). Thus, when the Supreme Court analyzed choice of law for WSSA and negligent misrepresentation claims (the claims FutureSelect asserts here), the Court chose ***not*** to apply the factors in Section 148; rather, the Court cited *Southwell* (and, hence, Section 145) as

[2] FutureSelect cites one federal case as "considering" Section 148 in assessing choice of law under Washington law. Br. at 18 (citing *Carideo v. Dell, Inc.*, 706 F. Supp. 2d 1122, 1129 (W.D. Wash. 2010)). But the Washington Supreme Court has ***not*** adopted Section 148, despite several opportunities to do so. *Carideo* does not bind this Court.

setting forth the controlling test. *See Haberman v. Wash. Pub. Power Supply Sys.*, 109 Wn.2d 107, 134, 744 P.2d 1032 (1987).

Under *Haberman*, Washington applies the "most significant relationship" test, analyzing the Restatement § 145 factors in light of their "relative importance," including the (a) place of injury, (b) place of alleged wrongful conduct, (c) parties' residence, and (d) center of the parties' relationship. *Singh v. Edwards Lifesciences Corp.*, 151 Wn. App. 137, 143, 210 P.3d 337 (2009). FutureSelect does not even attempt the Section 145 analysis. Instead, it urges the Court to hold Washington law applies because it resides in Washington and "received" representations here (though ***not*** from EY), without regard to the place of the alleged wrongful conduct or the center of the parties' relationship. Br. at 18–19.

But FutureSelect's choice of law shortcut contradicts Washington law. Washington courts hold the place of injury is of "lower importance" in misrepresentation cases. *See Kelley v. Microsoft Corp.*, 251 F.R.D. 544, 552 (W.D. Wash. 2008). Because "there may be little reason in logic or persuasiveness to say that one state rather than another is the place of injury," Restatement § 145 cmt. e, "the place of injury is ***less*** significant in the case of fraudulent misrepresentations." *Id.* cmt. f (emphasis added). In fact, Washington courts reject application of forum law where, as here, the "only significant contact with Washington … is Plaintiff's residency in Washington." *Rice*, 124 Wn.2d at 215. Thus, the fact that FutureSelect resides and claims injury in Washington does not justify applying

Washington law. Such a rule "would mean that Washington law would be applied in all tort cases involving any Washington resident, regardless of where all the activity relating to the tort occurred." *Id.* at 216. As *Rice* makes clear, Washington squarely rejects that approach.

FutureSelect's own authority makes the point. For example, FutureSelect cites *Ito International Corp. v. Prescott, Inc.*, 83 Wn. App. 282, 921 P.2d 566 (1996), to support its effort to apply Washington law, arguing Tremont (but ***not*** EY) "solicited" FutureSelect in Washington on one occasion. Br. at 19; CP 9 ¶ 34. In *Ito*, Japanese plaintiffs asserted claims arising from their purchase of limited partnership interests in a partnership that owned a building in downtown Seattle. This Court declined to apply the law of Japan, even though plaintiffs suffered injury there. Instead, the Court applied Washington law after observing (1) "all defendants reside or conduct business in Washington"; (2) "the investment involves Washington property"; (3) "the offering materials emanated from Seattle"; (4) "selling and marketing activity occurred in Seattle"; (5) "a Seattle attorney was involved in preparing and reviewing many transaction documents"; (6) "a cocktail party soliciting investors occurred in Seattle"; and (7) "many of the acts of alleged fraud occurred in Washington." *Ito*, 83 Wn. App. at 289–90.

None of these considerations favors application of Washington law here. Instead, they favor New York, where five defendants reside or are headquartered; FutureSelect made its investments; Tremont managed and

held the investments; EY's alleged misrepresentations originated; and EY's purportedly wrongful conduct occurred.

Other controlling cases confirm that New York law governs. In *Haberman*, for example, the Court found Washington had the "most substantial contacts with the subject matter" because (1) a Washington entity issued securities to finance construction in Washington; (2) the primary defendant was a Washington resident; (3) all defendants had "substantial business dealings in Washington"; and (4) the alleged misrepresentations "emanated" from Washington. 109 Wn.2d at 134–35. Similarly, in *Kelley*, the court found Washington had the "most significant relationship" under Restatement § 145 because "the conduct causing the injury" emanated from Washington and the defendant resided and "created the allegedly unfair or deceptive marketing scheme" in Washington. 251 F.R.D. at 552. These factors compel the application of New York law:

First, the events and conduct underlying FutureSelect's claims occurred in, and emanated from, New York. FutureSelect alleges EY "addressed" the audit reports to the "Partners" of the Rye Funds. But FutureSelect does not (and could not) allege EY sent these audit reports to it in Washington—as opposed to delivering the audit reports only to the general partner of the Rye Fund in New York. *See* CP 8, 10, 23 ¶¶ 27, 38, 89. And although FutureSelect alleges Tremont (not EY) once visited Washington, it does not allege any misrepresentations during that single contact. CP 9. By contrast, FutureSelect alleges its principal "regularly

visited Tremont" in New York, and during those trips Tremont purportedly made specific misrepresentations in ***New York*** about Madoff and his investments. *See* CP 11, 13. New York is also where (a) the Rye Funds were operated and managed; (b) its books and records were subject to audit; (c) Madoff operated his Ponzi scheme; and (d) FutureSelect lost its investments in the Rye Funds. *See* CP 2-3, 21 ¶¶ 2–4, 8, 79. Because virtually all of the alleged misconduct occurred in New York, this "significant" factor favors New York law, as "the jurisdiction in which the bad behavior … occurred." *Singh*, 151 Wn. App. at 145; *see also Kammerer v. W. Gear Corp.*, 27 Wn. App. 512, 520, 618 P.2d 1330 (1981) (applying California law where "the negotiations on which the fraud claim is based occurred in California"); *Kelley*, 251 F.R.D. at 552 (Washington gives "greater weight to … the location of the source of the injury" in misrepresentation cases).

Second, five defendants, including EY, are either headquartered or reside in New York.[3] And although FutureSelect is incorporated in Washington, the mere fact "that one of the parties is domiciled or does business in a given state will usually carry little weight of itself." Restatement § 145 cmt. e; *see Polygon Nw. Co. v. Nat'l Fire & Marine Ins. Co.*, 2011 WL 2020749, at *6 (W.D. Wash. May 24, 2011) (rejecting Washington law where "the only significant contact with Washington is [plaintiff's] incorporation here"). Further, in attempting to avoid

[3] Though not a resident of New York, Mass Mutual is headquartered in nearby Massachusetts. CP 7 ¶ 25.

dismissal, FutureSelect argued it sued for the benefit of its individual investors, who lost money because FutureSelect chose to invest with Madoff. CP 2153. But the investor letters FutureSelect filed with the trial court to buttress this argument showed that ***many*** FutureSelect investors reside (and hence suffered injury) ***outside*** Washington; indeed, some live in ***New York***. CP 3142, 2939, 2963, 2991.[4] The fact that FutureSelect's investors are scattered across the country reinforces why "there may be little reason in logic or persuasiveness to say that one state rather than another is the place of injury." Restatement § 145 cmt. e. Thus, "the state in which the fraudulent conduct arises [i.e., allegedly New York] has a stronger relationship to the action." *Kelley*, 251 F.R.D. at 552.

Third, the parties' relationship centers in New York. FutureSelect alleges Mr. Ward, its principal, "visited Tremont regularly" in New York to discuss its investments in these New York funds. CP 11-12 ¶ 39. By

[4] FutureSelect filed 115 individual investor statements to the Court as a "supplemental submission" after briefing on the motions to dismiss. *See* CP 2928-3105. The statements largely consisted of form letters from individuals urging the Court to allow this action to proceed, rather than deferring to an earlier-filed New York action, on the ground that the Washington action "gives ***me*** the best chance of recovering the losses ***I have sustained*** in connection with the Madoff fraud." *Id.* (emphasis added). EY pointed out the assertion of claims on behalf of individual investors required dismissal under the federal Securities Litigation Uniform Standards Act ("SLUSA"), which preempts state law securities claims brought "on behalf of more than 50 persons." 15 U.S.C. §§ 78bb(f)(1) (preempting "covered class actions" under state law); 15 U.S.C. §77bb(f)(5)(B)(i)(I) (defining "covered class action" to include any action seeking "damages ... on behalf of more than 50 persons"); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 82 (2006) (explaining purpose of SLUSA). Faced with this prospect, FutureSelect backtracked and emphasized during argument that "***the fund*** ... invested based on the [alleged] misrepresentations of these defendants," and the action was not in fact brought on behalf of individual investors. RP (May 17, 2011) 9:21-22 (emphasis added). Based on FutureSelect's concession that it sues on its own behalf for wrongs it allegedly suffered, EY does not pursue its SLUSA argument here.

contrast, FutureSelect does ***not*** allege EY visited FutureSelect in Washington ***at all***. And although FutureSelect alleges Tremont made one trip to Washington, it does ***not*** base its claims on any misrepresentations made during that one alleged in-state contact. In fact, nearly all events and communications alleged in the complaint revolve around FutureSelect's contacts with defendants at their offices in New York. *See Rice*, 124 Wn.2d at 214 (applying Oregon law under Section 145 where "relationship between the parties occurred in Oregon"); *Polygon*, 2011 WL 2020749, at *6 (rejecting Washington law where "the relationship between the parties is centered in Oregon" and "the overwhelming majority of the relevant contacts and conduct took place in Oregon").

In short, ***all*** "substantial contacts with the subject matter of the case" revolve around New York. *See Haberman*, 109 Wn.2d at 134. Because the significant Section 145 factors all favor New York, this Court should apply New York law.[5]

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[5] Because the Section 145 factors favor New York, the Court need not examine public policy issues. *See Johnson v. Spider Staging Corp.*, 87 Wn.2d 577, 582, 555 P.2d 997 (1976) (public policy implicated only where "contacts are evenly balanced"). In any event, public policy favors New York because "New York has a strong interest in defining the scope of liability for accountants who work in its state" and "it is unreasonable to allow ... any other law, to dictate the appropriate conduct for accountants or professionals vis-a-vis non-client third-parties where all of the events occurred in New York." *HSA Residential Mortg. Servs. of Tex. v. Casuccio*, 350 F. Supp. 2d 352, 365-66 (E.D.N.Y. 2003); *see Singh*, 151 Wn. App. at 148 (applying California law where conduct emanated from California; each "state has an interest in deterring its corporations from engaging in ... fraudulent conduct").

2. FutureSelect Fails to State a Claim under New York Law.

a. FutureSelect's Negligent Misrepresentation Claim Is Untimely and Defective under New York Law.

FutureSelect's negligent misrepresentation claim against EY is a malpractice claim because it rests on the allegation that EY did not adhere to professional standards when auditing the Rye Funds. *See* CP 45 ¶ 202. New York courts apply a strict three-year statute of limitations to malpractice actions, even when framed as negligent misrepresentation claims. *Rosenbach v. Diversified Grp., Inc.*, 12 Misc.3d 1152(A), 2006 WL 1310656, at *4 (N.Y. Sup. Ct. May 10, 2006) ("The[] allegations are basically those of a malpractice action, and therefore, the negligent misrepresentation claim is untimely, based on the 3-year statute of limitations for malpractice claims."). Further, "[i]n the context of a malpractice action against an accountant, the claim accrues upon the client's receipt of the accountant's work product," with no discovery rule. *Ackerman v. Price Waterhouse*, 84 N.Y.2d 535, 541, 644 N.E.2d 1009 (1994). Here, EY's role as auditor of the Rye Funds ended in 2003, and EY issued its last audit opinion on the 2003 year-end audit. *See* CP 8, 23 ¶¶ 27, 91. FutureSelect did not, however, file this suit until August 2010. CP 1. Because FutureSelect waited more than three years (indeed more than six years) after EY issued its last audit opinion, New York law bars its claim for negligent misrepresentation.

Further, even assuming FutureSelect filed a timely claim, it failed to allege facts sufficient to meet New York's "near-privity" requirement for negligent misrepresentation claims against an auditor. Under settled New York law, if the plaintiff is not in privity with the auditor by reason of a direct client-auditor relationship, it faces the heavy burden of alleging facts demonstrating a relationship with the auditor "so close as to approach that of privity." *Credit Alliance Corp. v. Arthur Anderson & Co.*, 65 N.Y.2d 536, 546, 483 N.E.2d 110 (1985) (citation omitted).

FutureSelect was not in privity with EY because, as the Complaint shows, it was never EY's audit client. *See* CP 8 ¶ 27 (identifying EY as auditor of the Rye Funds, not FutureSelect). Accordingly, *Credit Alliance* requires FutureSelect to allege that: (i) EY was aware when preparing its audit opinions that those opinions would be used for FutureSelect's particular purposes, i.e., future purchases in the Rye Funds; (ii) EY knew FutureSelect and intended FutureSelect to rely on its audit opinions; and (iii) EY engaged in ***direct*** "linking conduct" with FutureSelect evidencing EY's understanding FutureSelect would rely on its audit opinions. 65 N.Y.2d at 551. Conclusory allegations are not sufficient to avoid dismissal. *See Shutt v. Moore*, 26 Wn. App. 450, 453, 613 P.2d 1188 (1980) ("[g]eneral conclusory allegations" are insufficient to avoid dismissal under CR12(b)(6)). Instead, FutureSelect must allege facts supporting each element of the near-privity test. As the Second Circuit Court of Appeals has explained, "a plaintiff claiming negligent

misrepresentation against an accountant with whom he has no contractual relationship faces a heavy burden." *Sec. Investor Prot. Corp. v. BDO Seidman, LLP*, 222 F.3d 63, 73 (2d Cir. 2000). Here, FutureSelect fails to meet this heavy burden.

To satisfy the first element, FutureSelect must allege facts showing "a primary, if not the exclusive, *end and aim* of [EY's audits] . . . was to provide [FutureSelect] with the financial information it required." *Credit Alliance,* 65 N.Y.2d at 554 (emphasis in original). For the second element, FutureSelect must allege facts showing that EY "must have known when preparing the audit that the *particular plaintiffs* bringing the action would rely on its representations." *Sec. Investor Prot. Corp.*, 222 F.3d at 75 (emphasis in original). The third element requires FutureSelect to allege "some form of direct contact between the accountant and the plaintiff, such as a face-to-face conversation, the sharing of documents, or other 'substantive communication' between the parties." *Id.* New York courts developed these long-standing requirements to protect an auditor from "liability in an indeterminate amount for an indeterminate time to an indeterminate class." *Ultramares Corp. v. Touche*, 255 N.Y. 170, 179, 174 N.E. 441 (1931).

But FutureSelect does not allege any facts designed to satisfy the *Credit Alliance* test. FutureSelect does not allege that the "*end and aim*" of EY's audit was to provide FutureSelect with the information it needed to decide whether to invest with Madoff. Instead, FutureSelect alleges it

decided to invest in the Rye Funds in 1998 because it knew Madoff served as the Funds' investment adviser—more than two years before EY issued its first audit opinion on the 2000 financial statements. CP 8-10 ¶¶ 27, 34–37. FutureSelect's allegations do not distinguish its situation from the usual case in which an auditor prepares an opinion for its client, which the client subsequently passes on to potential investors or others. And in those circumstances, New York law rejects liability. *See, e.g.*, *Sec. Pac. Bus. Credit, Inc. v. Peat Marwick Main & Co.*, 79 N.Y.2d 695, 708, 586 N.Y.S.2d 87, 94 (1992) (distinguishing between audit work for the benefit of auditor's client and collateral uses of that audit by those to whom the auditor's client "might exhibit [the opinion] thereafter").

Nor does FutureSelect allege any "linking conduct" by EY. FutureSelect alleges only that EY "addressed" its audit opinions to the "partners" of the Rye Funds and that EY knew that the partners would rely on its opinions. S*ee* CP 23 ¶ 89. But FutureSelect does ***not*** allege EY sent or delivered the audit opinions to FutureSelect. And FutureSelect does ***not*** allege it met with EY, communicated on the telephone with EY, or requested or received investment advice from EY. Recognizing the strict requirements imposed by *Credit Alliance*, New York courts regularly dismiss negligent misrepresentation claims based on allegations similar to those FutureSelect alleges here. *See, e.g., Saltz v. First Frontier, LP*, 2010 WL 5298225, at *16 (S.D.N.Y. Dec. 23, 2010) (allegation that auditors knew their audit reports would be provided to fund's members and

potential investors and would be relied upon by them in making investment decisions was insufficient to establish "near privity" relationship); *Parrott v. Coopers & Lybrand, LLP*, 95 N.Y.2d 479, 741 N.E.2d 506 (2000) (auditor not subject to negligence liability where the plaintiff "never met or communicated" with the auditor and "[i]t [was] undisputed that there was no direct contact at any time" between them); *DaPuzzo v. Reznick Fedder & Silverman,* 14 A.D.3d 302, 303-04, 788 N.Y.S. 2d 69, 71 (N.Y. App. Div. 1st Dep't 2005) (where auditor performs work as part of ongoing relationship with a company and not for inducing particular investments, allegations that auditor knew plaintiffs would invest in the company as they had previously does not support the required "near privity"); *Houbigant, Inc. v. Deloitte & Touche LLP*, 303 A.D.2d 92, 94, 753 N.Y.S.2d 493 (N.Y. App. Div. 1st Dep't 2003) (requisite linking conduct not established by allegations that auditor consented to having its report forwarded to plaintiff and knew plaintiff would rely on the report).

The New York Supreme Court applied these principles in *CRT Investors, Ltd. v. Merkin*, 29 Misc.2d 1218(A), 2010 WL 4340433 (Sup. Ct. N.Y. Co. May 5, 2010), *aff'd*, 85 A.D.3d 470 (N.Y. App. Div. 2011), dismissing investors' negligent misrepresentation claim against the auditor of another fund that retained Madoff as investment adviser. In language that applies equally here, the court held:

> The fact that [the investors] were entitled to and received a copy of the audited financial statements, or that BDO Seidman [the auditor] knew that the investors would rely upon the information contained in the financial statements,

> does not establish the requisite linking conduct. ... BDO Seidman's work in the course of the audit was performed pursuant to professional standards applicable in the context of any audit, and was not undertaken pursuant to any specific duty owed to plaintiffs. Therefore, plaintiffs cannot establish the direct nexus necessary to give them a claim against BDO Seidman for negligent misrepresentation.

Id. at *12 (citations omitted).

Because FutureSelect's negligent misrepresentation claim fails under New York law, this Court should affirm dismissal.

b. FutureSelect Has Asserted No Statutory Cause of Action under New York Law.

Because New York law governs, the Washington State Securities Act ("WSSA") does not apply, and the Court need not consider the substance of FutureSelect's WSSA claims. In *Ito*, this Court made clear that application of the WSSA to out-of-state parties turns on the "most significant relationship" test. *Ito*, 83 Wn. App. at 289-90. *See also Haberman*, 109 Wn.2d at 134 (holding WSSA applied because Washington law governed under Restatement § 145 principles). As explained above, the most significant relationship test here requires application of New York law, not Washington law.

B. The Court Should Affirm Because FutureSelect's Claims Also Fail under Washington Law.

Even if this Court applies Washington law, the trial court properly decided that FutureSelect fails to state a claim.

1. The Complaint Fails to State a WSSA Claim.

Primary liability under the WSSA extends only to one who "offers or sells" a security. RCW 21.20.430(1).[6] A person qualifies as a "seller" under WSSA only if "his acts were a substantial contributive factor in the sales transaction." *Haberman*, 109 Wn.2d at 131. Although professionals who take an "active participation in the sales transactions" can incur seller liability under WSSA, those "whose role is confined to rendering routine professional services in connection with an offer" cannot. *Hines v. Data Line Sys., Inc.*, 114 Wn.2d 127, 149, 787 P.2d 8 (1990). In other words, the Supreme Court holds that professionals such as EY must do "something more" than render "routine professional services" to face WSSA seller liability. *Id.* at 149–50. Here, FutureSelect's WSSA claim fails because it alleges EY did nothing more than routine professional services—i.e., issue audit opinions on its clients' financial statements.

FutureSelect first argues that "seller" liability under WSSA "cannot be resolved on a motion to dismiss" because the "substantial contributive factor" test ordinarily presents a question of fact. Br. at 30. "But where reasonable minds can reach but one conclusion, questions of fact may be determined as a matter of law." *Hipple v. McFadden*, 161 Wn. App. 550, 561, 255 P.3d 730 (2011). Indeed, the Washington Supreme Court has squarely held that a court ***can*** resolve on a motion to

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[6] The WSSA also imposes secondary liability on some specific categories of persons. *See* RCW 21.20.430(3). FutureSelect has never alleged or argued that EY satisfied the test for secondary liability.

dismiss whether a defendant's acts are a "substantial contributive factor" under the WSSA. In *Kinney v. Cook*, 159 Wn.2d 837, 154 P.3d 206 (2007), the Court reinstated a trial court order granting the defendant's CR 12(b)(6) motion to dismiss, holding "Cook was not a seller" under WSSA because plaintiffs alleged no facts showing Cook "encouraging" the sales transaction. *Id.* at 845-46.

Here, FutureSelect fails to allege facts suggesting EY did anything to incur "seller" liability under WSSA. It does ***not*** allege EY engaged in "promotional conduct" or solicited sales transactions. *Shinn v. Thrust IV, Inc.*, 56 Wn. App. 827, 851, 786 P.2d 285 (1990) (no seller liability under WSSA in "absence of any real promotional conduct" by defendant). It does ***not*** allege EY had "attributes of a seller" or acted as a "catalyst" in the sales transaction. *Brin v. Stutzman*, 89 Wn. App. 809, 830, 951 P.2d 291 (1998) (dismissing WSSA claim where, although plaintiff "made her investment decision based on the [defendant's] advice," defendant "had no attributes of a seller"). It does ***not*** allege EY "marketed" the Rye Funds or "solicited" FutureSelect's investment in them. *Schmidt v. Cornerstone Invest.*, 115 Wn.2d 148, 165–66, 795 P.2d 1143 (1990) (dismissing WSSA claim where escrow agent was not "involved in marketing [the property] or in soliciting plaintiffs to make the investment"). And it does ***not*** allege EY had "active participation in the sales transaction" or "personal contact with any of the investors or was in any way involved in the solicitation process." *Hines*, 114 Wn.2d at 149–50 (law firm's "participation in the

sales transaction is insufficient under the *Haberman* test to constitute a 'seller'"). Instead, FutureSelect alleges only that EY did the work of an auditor, i.e., it performed audits and issued "unqualified audit opinions on the Rye Funds," and that FutureSelect (which invested in the Rye Funds years before EY audited two funds) "relied" on those audits in adding to its holdings. CP 8, 22-23 ¶¶ 27, 87–89. These allegations do not state a claim for "seller" liability under the WSSA. *Hines*, 114 Wn.2d at 149.

FutureSelect argues EY "went beyond providing routine services" because it allegedly "knowingly consented" to Tremont using its audit reports to solicit investors and "communicated with FutureSelect" by requesting confirmation of its investments during the audit process. Br. at 31. In other words, under FutureSelect's theory of WSSA liability, ***all*** auditors of such funds would become "sellers" merely by conducting an audit, requesting confirmations of investments by limited partners or shareholders, and allowing (or at least not forbidding) clients to show the audit report to third parties. But the Washington Supreme Court has squarely rejected this theory, requiring "something more" before professionals face liability for such routine services. *Hines*, 114 Wn.2d at 149–50. FutureSelect's allegations confirm only that EY performed the routine tasks required for an audit; they do not suggest EY's "active participation in the sales transaction."[7] *Id.*

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[7] FutureSelect also materially misstates the relevant test. As the Washington Supreme Court makes clear, the question is whether the professional's conduct was "a substantial contributive factor ***in the sales transaction***." *Haberman*, 109 Wn.2d at 131 (emphasis added). FutureSelect instead suggests it need only show that EY was "'a substantial

Seeking to expand the scope of "seller" liability, FutureSelect resorts to a federal trial court decision that no Washington appellate court has adopted or followed. Br. at 32 & n. 6 (citing *In re Metro. Sec. Litig.*, 532 F. Supp. 2d 1260, 1301 (W.D. Wash. 2007)). Under *Metropolitan*, ***every*** auditor would become a "seller" of its client's securities simply by issuing an audit opinion—the professional service for which clients retain auditors. (Indeed, *Metropolitan* rests on the premise that auditors by definition ***cannot*** render routine professional services, 532 F. Supp. 2d at 1301,[8] an extreme proposition with no support in Washington law.) But *Metropolitan* runs counter to Washington law, and this Court should decline to follow it; instead, *Hines* controls. In holding that professionals must do "something more" than render "routine professional services" to face WSSA liability, *Hines* relied on *Ahern v. Gaussoin*, 611 F. Supp. 1465, 1485 (D. Or. 1985). *Hines*, 114 Wn.2d at 149–50. And in *Ahern*, the court held an accounting firm was ***not*** a substantial contributive factor in the sales transaction (as required to be a seller under then-existing federal law), even though it (a) issued clean audit opinions, 611 F. Supp. at 1472; (b) assisted in preparing a securities registration statement, *id.* at 1485; and (c) gave a speech to investors reporting the accounting firm had given the client "a clean bill of health." *Id.* at 1486.

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contributing factor' to FutureSelect's injury." Br. at 31. No court has ever adopted such a formulation, which would make proximate causation the test for seller status.

[8] As its ***only*** support for this proposition, *Metropolitan* relied on dictum plucked out of context from *United States v. Arthur Young & Co*, 465 U.S. 805, 817-18 (1984), which dealt with the unrelated issue of whether the work product privilege protected an accountant's work papers from disclosure to the IRS.

Ahern shows that FutureSelect has not alleged facts to take EY's work out of the realm of routine professional services. Under *Hines*, which approved *Ahern*'s reasoning, that shortcoming compels dismissal.

2. The Complaint Fails to State a Washington Negligent Misrepresentation Claim.

Washington follows the Restatement (Second) of Torts § 552 (1977) to determine whether a plaintiff has stated a negligent misrepresentation claim. *Haberman*, 109 Wn.2d at 161. In adopting Section 552, Washington "***limit[ed]*** the class of persons who can bring negligent misrepresentation claims" to those who rely on misinformation "in a transaction that [defendant] intends the information to influence or knows that the recipient so intends." *Esca Corp. v. KPMG Peat Marwick*, 135 Wn.2d 820, 832, 959 P.2d 6510 (1998) (citation omitted; emphasis added). To state a negligent misrepresentation claim, FutureSelect therefore must allege it relied on EY's audit opinions "in a transaction that [EY] ***intends the information to influence***." Restatement § 552(2)(b) (emphasis added). Because FutureSelect alleges no facts suggesting EY intended its audit reports to influence FutureSelect to buy more shares in the Rye Fund, it fails to state a negligent misrepresentation claim under Washington law.

FutureSelect's negligent misrepresentation argument relies almost exclusively on *Haberman*. Br. at 37–38. But FutureSelect misreads *Haberman*. In that case, a select "group of institutional bondholders, including American Express Travel Related Services Company, Inc.

(Amexco) and United States Trust Company of New York" intervened as plaintiffs to assert negligent misrepresentation claims—which the larger group of bondholders did ***not*** assert. *Haberman*, 109 Wn.2d at 118-19. The institutional bondholders alleged they received special attention, i.e., that the "[defendant] professionals made personal visits and telephone calls on several occasions" to discuss their purchase of the bonds. 109 Wn.2d at 163–64. On these allegations of direct contact between the defendant professionals and the small group of institutional investors, the Court found it "conceivable that each of the respondent professionals were told by [their client] of its intent to supply information received from the professionals directly to institutional investors … to induce them to ***purchase*** bonds." *Id.* at 164 (emphasis added). The Court thus found those few institutional investors "would be part of a limited group which the professionals knew would receive their information and rely on it in making a decision to purchase bonds." *Id.*

Here, FutureSelect does ***not*** allege EY ever singled out FutureSelect for special treatment, much less made any "personal visits" or calls to FutureSelect to induce its investment in the Rye Funds. Nor does FutureSelect allege facts to suggest EY was "told by [Tremont]" of any intent to use its audits to induce FutureSelect to ***purchase*** shares in the Rye Funds—the "sales" on which FutureSelect bases its claim. Without these allegations, FutureSelect has not alleged facts remotely approaching those that supported a negligent misrepresentation claim in *Haberman*.

Unable to allege any direct connection to EY, FutureSelect relies on the proposition that EY addressed its audit reports generically to "the partners of the Rye Funds," which included funds FutureSelect managed. Br. at 37. But that allegation shows EY addressed the audit reports to partners in their capacity as ***current*** owners of the Rye Funds—not as ***future*** purchasers. CP 8 ¶ 27. Under the governing Restatement test, that fact matters: to state a negligent misrepresentation claim, FutureSelect must allege reliance on misinformation "in a transaction that [EY] ***intends the information to influence*** or knows that the recipient so intends." Restatement § 552(2)(b) (emphasis added). "The Restatement's approach allows for liability to be extended beyond those persons in privity with the accountant, but ***only*** when the accountant knows at the time the work is done that a ***limited group*** of third persons intend to rely upon the work for a ***specific transaction***." *Machata v. Seidman & Seidman*, 644 So.2d 114, 115-16 (Fla. Ct. App. 1994) (emphasis added) (dismissing under Section 552 test where "accountants were not alleged to have been aware of a specific transaction at the time of the undertaking for which the work was to be used"). Here, FutureSelect alleges nothing to suggest EY intended to influence the Rye Funds' partners to make ***additional*** securities purchases.

Many cases have reached the same conclusion under the Restatement test that *Haberman* adopted as Washington law. *See, e.g.*, *Spear v. Ernst & Young*, 1994 WL 585815, at *10 (D. S.C. Aug. 15, 1994) (dismissing under Section 552 test where auditor's alleged misinformation

was "not prepared specifically for the guidance of a particular person or persons"); *Bacon v. Stiefel Labs.*, 677 F. Supp. 2d 1331, 1352 (S.D. Fla. 2010) (dismissing under Section 552 where no allegation accountants "knew that the Plaintiffs, as Employee Plan participants, relied upon their valuation of Company Stock in making the decision as to whether and when to put their stock to the Company under the Employee Plan").

Finally, FutureSelect cannot satisfy its pleading obligation by blandly alleging that "E&Y knew that FutureSelect would rely on its audit reports in purchasing and retaining ownership interests in the Rye Funds." CP 45 ¶ 202. Indeed, the Restatement specifically rejects this sort of allegation as the basis for liability: Illustration 10 to Restatement § 552 explains that liability will ***not*** attach where the facts show only that the speaker "kn[e]w that the financial statements, accompanied by [its] opinion … may be relied upon by lenders, investors, shareholders, creditors, purchasers and the like, in numerous possible kinds of transactions." FutureSelect's allegations thus do ***not*** meet the "narrow[] scope of an action for negligent misrepresentations" under Washington law. *Haberman*, 109 Wn.2d at 161–62.

"To predicate [EY's] duty to third parties on such things as the general knowledge that accountants possess about typical investors or tenuous inferences concerning future events would be to eviscerate the Restatement rule in favor of a de facto foreseeability approach," *Scottish Heritable Trust, PLC v. Peat Marwick Main & Co.*, 81 F.3d 606, 614 (5th

Cir. 1996)—an approach Washington rejected in adopting the "limited" Restatement test. Without factual allegations suggesting EY was "manifestly aware of the use to which the information was to be put and intended to supply it for that purpose," FutureSelect fails to state a claim for negligent misrepresentation. *Haberman*, 109 Wn.2d at 162 (quoting Restatement § 552, cmt. a).

IV. CONCLUSION

For the foregoing reasons, the Court should affirm the trial court's order dismissing with prejudice FutureSelect's claims against EY.

RESPECTFULLY SUBMITTED this 16th day of May, 2012.

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IN THE COURT OF APPEALS
OF THE STATE OF WASHINGTON
DIVISION I

FUTURESELECT PORTFOLIO MANAGEMENT, INC., FUTURE SELECT PRIME ADVISOR II LLC, THE MERRIWELL FUND, L.P., and TELESIS IIW, LLC, Plaintiffs/Appellants, v. TREMONT GROUP HOLDINGS, INC., TREMONT PARTNERS, INC., OPPENHEIMER ACQUISITION CORPORATION, MASSACHUSETTS MUTUAL LIFE INSURANCE CO., and ERNST & YOUNG LLP, Defendants/Respondents.	No. 68130-3-I CERTIFICATE OF SERVICE OF BRIEF OF RESPONDENT ERNST & YOUNG

I hereby certify that on May 16, 2012, I caused a true and correct copy of *Brief of Respondent Ernst & Young* to be served on counsel of