**UNITED STATES DISTRICT COURT**
**FOR THE DISTRICT OF VERMONT**

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| MICHAEL S. PIECIAK, in his official capacity as COMMISSIONER OF THE VERMONT DEPARTMENT OF FINANCIAL REGULATION, solely as LIQUIDATOR of GLOBAL HAWK INSURANCE COMPANY RISK RETENTION GROUP,<br><br>Plaintiff,<br><br>v.<br><br>CROWE LLP,<br><br>Defendant. | Case No. 5:21-cv-00273-gwc<br><br>Hon. Geoffrey W. Crawford<br><br>**ORAL ARGUMENT REQUESTED** |

**CROWE LLP'S REPLY IN SUPPORT OF ITS MOTION TO DISMISS**

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## I. The Plaintiff Concedes His Failure to Allege that Crowe Violated GAAS.

In its Motion, Crowe established that the Complaint fails to allege a violation of any Generally Accepted Auditing Standard ("GAAS"). (Mot. at 7-8.) More specifically, nothing in GAAS required Crowe to confirm Global Hawk's assets and capital contributions with the custodians of those funds; instead, GAAS permits an auditor to obtain confirmation from anyone whom "the auditor believes is knowledgeable about the information to be confirmed." AU-C § 505.A3. (*See also* Mot. at 7-8.) The Plaintiff does not and cannot allege that Crowe breached this obligation or any other GAAS standard.

The Plaintiff's Response does not dispute this (*see* Resp. at 6-8), so the Plaintiff has waived any argument that Crowe violated GAAS. *See In re Kingate Mgmt. Ltd. Litig.*, 746 F. App'x 40, 43 (2d Cir. 2018) (affirming district court's finding that an argument was waived because it was not raised in response to a motion to dismiss). The Plaintiff's inability to allege any violation of GAAS is fatal to all of his claims, because (i) the contract governing Crowe's work required Crowe to follow GAAS; and (ii) Crowe expressed its audit opinions in terms of GAAS. Thus, the governing standard is GAAS, not some amorphous standard that the Plaintiff invented years after Crowe completed its audit work.

Crowe and Global Hawk specifically agreed in their fully integrated contract that Crowe's audits would be performed in accordance with GAAS. (Mot. at 4, Ex. B at 1, 4; Compl. at ¶¶ 115, 120, 125.) And when Crowe expressed its audit opinions, both in its audit reports and in each of its filings with the Department, Crowe expressly disclosed that its audit opinions were rendered under GAAS, not some other standard. (Resp., Exs. A-C at 1; Compl. at ¶¶ 16-18.) Crowe is not merely "presuppos[ing]" that GAAS is the appropriate measure of its work. (Resp. at 7.) The contract expressly required Crowe to follow GAAS, and Crowe never expressed any audit opinion under any standard other than GAAS.

A case cited by the Plaintiff, *NCP Litigation Trust v. KPMG LLP*, 901 A.2d 871, 888 (N.J. 2006), recognizes that an auditor's "liability must be defined by the scope of the engagement it entered into with [the audit client]." Other courts have reached the same conclusion. *See Machata v. Seidman & Seidman*, 644 So. 2d 114, 115 (Fla. Dist. Ct. App. 1994) ("the scope of the accountant's liability [is] restricted to the scope of its undertaking"). The duty owed by the auditor is defined by "the contractual obligation for [the auditor] to conduct auditing services for [the audit client]." *NCP*, 901 A.2d at 888. Courts look to these "understandings and agreements to determine whether [the auditor] violated any duty." *Id.* at 889. In the Iowa and Oregon decisions on which the Plaintiff relies, the courts did not consider contracts which defined the auditor's undertaking. (*See* Resp. at 7.) Indeed, it would be fundamentally unfair to impose a standard on Crowe that differs from the standard that both Crowe and Global Hawk contractually selected to govern Crowe's work, and to suddenly impose some new standard upon Crowe years after its work was done. It would be equally unfair to hold Crowe's audit opinions to a standard that differs from the one Crowe consistently referenced when it expressed those opinions.

The Plaintiff's reliance on *Nordica USA, Inc. v. Deloitte & Touche*, 839 F. Supp. 1082, 1089 (D. Vt. 1993), is entirely misplaced. In *Nordica*, the defendant auditor merely argued that "the complaint does not cite the specific accounting standards that were violated." *Id*. Here, Crowe is not complaining merely that the Plaintiff neglected to cite relevant GAAS provisions. Rather, Crowe has established—and the Plaintiff does not dispute—that the conduct alleged in the Complaint does not violate *any* GAAS standard.

In short, all of the Plaintiff's claims depend on holding Crowe to a different audit standard than the one mandated by the contract for Crowe's services and the one Crowe always said it was using whenever it expressed audit opinions. For that reason alone, all of the Plaintiff's claims fail.

## II. The Plaintiff Cannot Avoid the Written Contract that Governed Crowe's Work.

In its Motion, Crowe established that Count VII of the Complaint is time-barred under the contract between Crowe and Global Hawk. (Mot. at 21-22.) The Plaintiff does not dispute that the contract selects Illinois as the governing law, or that this provision is valid under Illinois law. Instead, the Plaintiff conducts a cursory choice of law analysis, argues that Vermont law governs the contract, and contends that the limitations provision is "null and void" under Vermont law. (*See* Resp. at 20.) But the Plaintiff's attempt to apply Vermont law is misplaced. The contract expressly states that it is governed by Illinois law, "*without regard* for choice of law principles," so the application of Illinois law cannot be defeated by resorting to a choice of law analysis. (Mot., Ex. B at 4 (emphasis added).) *See OrbusNeich Med. Co., BVI v. Bos. Sci. Corp.*, 694 F. Supp. 2d 106, 114 (D. Mass. 2010) (court "is not at liberty to disregard the parties' addition of the phrase 'without regard to the conflicts of law provisions'"); *In re Sterba*, 852 F.3d 1175, 1181 (9th Cir. 2017) (Tashima, J., concurring). Vermont courts generally enforce contractual choice of law provisions (Mot. at 21), and there is no valid reason not to enforce this one.[1]

Crowe's Motion also established that Counts I, IV, and VII are barred by the 2016 Engagement Agreement's prohibition on recovering consequential damages. The Plaintiff does

[1] The Plaintiff's further argument that Illinois has no substantial relationship to the contract is simply wrong. As the Plaintiff concedes, Crowe is headquartered in Illinois. (Compl. at ¶ 4.) The Plaintiff also fails to establish that there is "no other reasonable basis for the parties' choice" of law, or that the application of Illinois law would be contrary to a "fundamental policy" of Vermont. *See* Restatement (Second) of Conflict of Laws § 187(2) (1971). Vermont courts will refuse to enforce a choice of law provision on public policy grounds only to avoid a result that is "cruel or shocking to the average man's conception of justice." *Vinci v. V.F. Corp.*, No. 2:17-CV-00091, 2018 WL 339942, at *3 (D. Vt. Jan. 9, 2018). The Plaintiff cites no case holding that two sophisticated parties' written agreement to a two-year limitations period is somehow cruel or shocking to the conscience.

not dispute that he seeks consequential damages. Rather, he again just asks the Court to ignore the written contract. The Plaintiff makes several arguments in support of that request. Each one fails.

First, the Plaintiff argues that the limitation on consequential damages applies only to contract claims, not tort claims. But that ignores the contract's actual language, which expressly applies to "*[a]ny* liability." (Mot., Ex. B at 3 (emphasis added).) In addition, the same provision bars punitive damages, which under Illinois law are recoverable only in tort. *See Morrow v. L.A. Goldschmidt Assocs., Inc.*, 492 N.E.2d 181, 183 (Ill. 1986) (no punitive damages even for a willful breach of contract). If the provision applied only to contract claims, there would be no need to exclude punitive damages. *See Lefebvre Intergraphics, Inc. v. Sanden Mach. Ltd.*, 946 F. Supp. 1358, 1372 (N.D. Ill. 1996) (consequential damages exclusion applied to both tort and contract claims); *see also Gates Rubber Co. v. USM Corp.*, 508 F.2d 603, 617 (7th Cir. 1975).

Next, the Plaintiff argues that Crowe implicitly waived the bar on consequential damages, apparently on the theory that Crowe would otherwise have violated a commitment in a regulatory filing not to enter "an agreement of indemnity or release from liability." (*See* Resp. at 22.) But waiver is "the intentional relinquishment of a known right" and must be "an affirmative act and not by operation of law." *W. Cas. & Sur. Co. v. Brochu*, 475 N.E.2d 872, 878 (Ill. 1985). The Plaintiff is advocating for a finding of waiver by operation of law, which is simply not permitted. *Id*. Crowe never said it was waiving any rights under the contract. *Cf. Kanaan v. Kanaan*, 659 A.2d 128, 136 (Vt. 1995) (waiver cannot be inferred from silence).

The Plaintiff next unsuccessfully invokes public policy in an effort to avoid the bar on consequential damages. Contrary to the Plaintiff's argument, however, that provision never "exempt[s] [Crowe] from damages." (*See* Resp. at 24.) Nor does it "insulat[e] Crowe from the consequences of its breaches of its duty of due care," nor is it an "exculpation for all breaches and

negligence . . . .” (*Id.* at 23.) Instead, it simply limits recoverable damages. *See Lefebvre*, 946 F. Supp. at 1372. The Plaintiff’s public policy argument thus rests on a misunderstanding of what the consequential damages bar actually does.

Finally, the Plaintiff’s undeveloped argument that relevant contract provisions are somehow unconscionable does not even merit the Court’s consideration. *See MAN Roland Inc. v. Quantum Color Corp.*, 57 F. Supp. 2d 568, 575–76 (N.D. Ill. 1999) (court should not consider unconscionability claim that was not raised in the complaint and instead was raised for the first time in response to a motion to dismiss). In any event, a bar on recovering consequential damages is not unconscionable. *See McNally Wellman Co., a Div. of Boliden Allis v. New York State Elec. & Gas Corp.*, 63 F.3d 1188, 1198 (2d Cir. 1995); *Lefebvre*, 946 F. Supp. at 1372.

**III. The Contract Claims Are Barred By Global Hawk’s Prior Material Breaches.**

The Plaintiff’s breach of contract claims are barred by Global Hawk’s prior material breaches of those same contracts. (Mot. at 19-21.) In response, the Plaintiff contends that “Crowe merely quotes the engagement letter and asserts breach,” and that Global Hawk’s misconduct “was not directed at Crowe[.]” (*See* Resp. at 19.) Both of these contentions are false. Global Hawk agreed to fulfill numerous obligations to Crowe as material terms of Crowe’s agreement to perform audit services for Global Hawk. (Mot. at 20.) The Plaintiff admits that Global Hawk breached these obligations by deliberately providing false information to Crowe for the specific purpose of thwarting its ability to accurately assess Global Hawk’s financial condition. (*See* Compl. at ¶¶ 57, 63, 67; Mot., Ex. A at ¶¶ 33-36, 41, 71, 88.) These “mere assertions” were made not by Crowe, but by the Plaintiff in his lawsuit against the man who controlled Global Hawk.

While the Plaintiff never denies (and cannot deny) that he stands in Global Hawk’s shoes, he repeatedly argues that his rights are broader than Global Hawk’s because he seeks to vindicate the interests of policyholders and other creditors. (*See* Resp. at 19.) But no policyholder or creditor

was a party to the contract, and there is no basis in law for the Plaintiff's apparent belief that he can somehow sue Crowe in contract on behalf of unidentified individuals who were not parties to the contract. It is only due to the Plaintiff's status as Global Hawk's successor that he has standing to assert claims against Crowe for breach of contract, so the Plaintiff's rights under the contract extend no further than Global Hawk's. (Mot. at 19-21.) A liquidator takes the liquidated entity's contract claims as he or she finds them. *Costle v. Fremont Indem. Co.*, 839 F. Supp. 265, 272 (D. Vt. 1993).

The Plaintiff next asserts that "fraud by management is not enough to vitiate Crowe's audit obligations." (*See* Resp. at 19.) To support that claim, the Plaintiff cherry picks the phrase "whether due to error or fraud" from Crowe's Engagement Agreements and, wrenching that sole phrase out of context, argues that Crowe guaranteed it would detect any and all fraud. (*See id*.) In truth, the Engagement Agreements state:

> An audit requires that we obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Because of inherent limitations of an audit, together with the inherent limitations of internal control, an unavoidable risk that some material misstatements may not be detected exists, even though the audit is properly planned and performed in accordance with GAAS.

(Mot., Group Ex. B at 1.)

Contracts should be interpreted as a whole. *See Gallagher v. Lenart*, 874 N.E.2d 43, 58 (Ill. 2007); *State v. Philip Morris USA Inc.*, 945 A.2d 887, 892 (Vt. 2008). Here, the contract expressly stated that: (1) Crowe would perform its audit under GAAS; (2) there was an "unavoidable risk" that misstatements would go undetected; and (3) Crowe had no duty to obtain "absolute" assurance that the financials were free of material misstatements. (Mot., Ex. B at 1.)

Indeed, GAAS recognizes that proper audit procedures "may be ineffective for detecting" precisely the type of fraud that the Plaintiff contends occurred here: "intentional misstatement[s]

that involve, for example, collusion to falsify documentation that may cause the auditor to believe that audit evidence is valid when it is not." *See* AU-C § 200.A51. (*See also* Compl. at ¶¶ 57, 63, 67; Mot., Ex. A at ¶¶ 1, 23, 28, 30-71.) Crowe promised to conduct its audit in accordance with GAAS, and GAAS specifies that "[t]he auditor is neither trained as, nor expected to be, an expert in the authentication of documents." AU-C § 200.A51.

**IV. The Plaintiff Fails to Adequately Allege Causation.**

Crowe's Motion also established that all of the Plaintiff's claims are barred because Jasbir Thandi's misconduct constitutes an "efficient, intervening cause" that broke the chain of causation. (Mot. at 16-17.) The Plaintiff contends that Thandi's fraud cannot be an intervening cause because it occurred first, and that Crowe should have foreseen it. (*See* Resp. at 15-16.) Both arguments fail.

First, the Complaint establishes this sequence of events: (1) Global Hawk hired Crowe to audit its financials; (2) Crowe then sought and received documents and representations from Global Hawk and other confirming parties; (3) in response, Thandi and his co-conspirators then gave Crowe forged documents to misrepresent Global Hawk's financial condition; and (4) Crowe then issued its audit report. (*See* Compl. at ¶¶ 57, 63, 67; Mot., Ex. A at ¶¶ 33-36, 41, 71, 88.) The intervening cause consisted of Thandi and his co-conspirators' lies to Crowe.

Second, under GAAS, an auditor is *not* required to anticipate that management is engaging in fraud and forging documents. *See* AU-C § 240.13 ("Unless the auditor has reason to believe the contrary, the auditor may accept records and documents as genuine."). Under GAAS, Crowe was entitled to rely on management's documents and representations in preparing its audit reports. The Plaintiff asserts that Global Hawk's fraud was "legal[ly] foreseeab[le]" because Crowe purportedly agreed to detect misstatements "whether due to fraud or error." (*See* Resp. at 16.) But as set forth above, the Plaintiff misleadingly takes this phrase out of context. Even in the Letters of

Qualifications attached to the Plaintiff's Response, Crowe specifically stated that "[b]ecause of the characteristics of fraud, a properly planned and performed audit may not detect a material misstatement resulting from fraud." (Resp., Exs. A-C at 1.)

**V. The Plaintiff Fails to Allege Cognizable Damages.**

The Plaintiff's "deepening insolvency" theory fails to allege cognizable damages because, without more, the mere "deepening of a firm's insolvency is not an independent form of corporate damage." *See In re CitX Corp., Inc.*, 448 F.3d 672, 678 (3d Cir. 2006). In response, the Plaintiff exaggerates Crowe's argument as postulating that "Global Hawk was not harmed but benefitted by the prolongation of its existence due to Thandi's conduct . . . ." (*See* Resp. 17.) In fact, Crowe's argument is that the prolongation of a company's life through deepening insolvency is not *inherently* harmful to the company. (Mot. at 17-18.) While Global Hawk ultimately did not benefit from the prolongation of its existence, that was not because of anything *Crowe* allegedly did. That was the fault of Global Hawk's managers, who failed to turn the company around. It is only "through hindsight bias" that the Plaintiff can claim its damages proximately flowed from the mere deepening of Global Hawk's insolvency. *See CitX*, 448 F.3d at 678.

**VI. The Doctrine of *In Pari Delicto* Bars The Plaintiff's Claims.**

The Plaintiff's claims are barred by the doctrine of *in pari delicto*. (Mot. at 8-16.) In response, the Plaintiff relies on *NCP* to argue that *in pari delicto* does not apply because "the accounting firm 'is not a victim of the fraud in need of protection.'" (Resp. at 11.) But in *NCP*, the trustee alleged that the auditor engaged in misconduct that was independent of any misrepresentations by the audit client's management. For example, the trustee alleged that the auditor knowingly allowed for an "improper reversal of an approximate $1.8 million liability" in violation of GAAP, and that the auditor failed to require the client to accrue liabilities in violation

of GAAS. *See NCP*, 901 A.2d at 877. Here, by contrast, the Plaintiff alleges no GAAS violations, only that Crowe fell victim to misrepresentations by Global Hawk's management.

Second, the Plaintiff invokes his authority to sue on behalf of policyholders and creditors. The Plaintiff claims that, because Global Hawk's innocent stakeholders will benefit from a recovery in this case, the rationale for *in pari delicto* does not apply. (*See* Resp. at 11-12.) But there are innocent stakeholders on *both* sides of the equation. As explained in *Kirschner v. KPMG*:

> In a sense, plaintiffs' proposals may be viewed as creating a double standard whereby the innocent stakeholders of the corporation's outside professionals are held responsible for the sins of their errant agents while the innocent stakeholders of the corporation itself are not charged with knowledge of their wrongdoing agents. And, of course, the corporation's agents would almost invariably play the dominant role in the fraud and therefore would be more culpable than the outside professional's agents who allegedly aided and abetted the insiders or did not detect the fraud at all or soon enough. The owners and creditors of [Crowe] may be said to be at least as "innocent" as [Global Hawk's policyholders and creditors].

*Kirschner v. KPMG LLP*, 938 N.E.2d 941, 958 (N.Y. 2010).

At bottom, the law will not hear an audit client complain (whether on its own behalf, on behalf of its policyholders and creditors, or through its successor) that its auditor negligently prepared its audit report, where the audit client—through fraud and other intentional misconduct—deliberately impeded the auditor's preparation of the report, and the auditor's alleged transgression is limited to having fallen victim to the fraud. (Mot. at 9.)

The Plaintiff next invokes the adverse interest exception, arguing that Thandi's misconduct is not imputed to Global Hawk because Thandi was acting contrary to Global Hawk's best interests. (Resp. at 12-13.) But as established in Crowe's Motion (Mot. at 11-13), the aim of Thandi's fraudulent concealment of Global Hawk's financial condition was to allow Global Hawk to "continue in business." (*See id.*, Ex. A at ¶¶ 1, 23, 74, 76.) *See Seidman & Seidman v. Gee*, 625 So.2d 1, 3 (Fla. Dist. Ct. App. 1992) (management's fraudulent misrepresentation benefited corporation so as to preclude application of the adverse interest exception where the

misrepresentation "was the prerequisite to the corporation's approval to continue in business," even if the misrepresentations caused "the ultimate financial demise" of the corporation); *Kirschner*, 938 N.E.2d at 953 ("[F]or the adverse interest exception to apply, the agent must have *totally abandoned* his principal's interests and be acting *entirely* for his own or another's purposes, not the corporation's.") (emphasis in original) (cleaned up).

Finally, even if the adverse interest exception would otherwise apply, Thandi's fraud is still imputed to Global Hawk under the sole actor doctrine. (Mot. at 13-14.) The Plaintiff tries to defeat the sole actor doctrine by asserting that some unnamed "independent directors" worked for Global Hawk (Resp. at 13), but the bare allegation of "*any* innocent officer, director or shareholder [does not] avoid the imputation of fraudulent acts by management to the corporation." *Breeden v. Kirkpatrick & Lochart, LLP*, 268 B.R. 704, 710 (S.D.N.Y. 2001) (emphasis in original), *aff'd*, *In re Bennett Funding Grp., Inc.*, 336 F.3d 94 (2d Cir. 2003). Moreover, the Plaintiff alleges that Thandi, not independent directors, controlled Global Hawk. (*See* Mot. at 14.)

**CONCLUSION**

The Complaint should be dismissed with prejudice pursuant to Fed. R. Civ. P. 12(b)(6).

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Respectfully Submitted,

**CROWE LLP**

By: /s/ *Matthew B. Byrne*
One of Its Attorneys

UNITED STATES DISTRICT COURT
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| MICHAEL S. PIECIAK, in his official, capacity as COMMISSIONER OF THE VERMONT DEPARTMENT OF FINANCIAL REGULATION, solely as LIQUIDATOR OF GLOBAL HAWK INSURANCE COMPANY RISK RETENTION GROUP,<br>Plaintiff | ) | Case No. 5:21-cv-273 |
| v. | ) | |
| CROWE LLP,<br>Defendant | ) | |

CERTIFICATE OF SERVICE

I, Matthew B. Byrne, Esq., attorney for Defendant Crowe LLP, certify that, on February 18, 2022, I caused to be served Defendant's Reply in Support of its Motion to Dismiss through the CM/ECF system on the following individuals:

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Dated: Burlington, Vermont
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