Court File No. CV-12-454648

ONTARIO
SUPERIOR COURT OF JUSTICE

B E T W E E N:

**FAIRFIELD SENTRY LIMITED,
FAIRFIELD SIGMA LIMITED, FAIRFIELD LAMBDA LIMITED AND
KENNETH KRYS, AS LIQUIDATOR FOR FAIRFIELD SENTRY LIMITED,
FAIRFIELD SIGMA LIMITED AND FAIRFIELD LAMBDA LIMITED**

Plaintiffs

- and -

PRICEWATERHOUSECOOPERS LLP AND STEPHEN WALL

Defendants

STATEMENT OF DEFENCE AND COUNTERCLAIM OF PRICEWATERHOUSECOOPERS AND STEPHEN WALL

A. ADMISSIONS AND DENIALS

1. The defendants PricewaterhouseCoopers LLP and Stephen Wall (collectively "**PwC**") admit the allegations contained in the first two sentences of paragraphs 5, paragraph 6(b) (but not for the completeness of the statements contained therein), the first and third sentences of paragraphs 13, 14 and 15, paragraphs 19, 21, 22, 25 (but only that Sentry (defined below) entrusted substantially all of its assets in securities purportedly held by BLMIS (defined below) paragraph 26 (but only that BLMIS acted as "a" broker not "the" broker for Sentry with the balance of the allegations being denied), paragraph 27 (but only that BLMIS acted as a sub-custodian of the assets of Sentry with the balance of the allegations being denied), paragraphs 29 to 31 (save that PwC will rely on the investment policies of the plaintiffs as a whole), 36, 37

(save that PwC will rely on the engagement letters as a whole), 42, 45, 46, 47, 49, 52, 53, 54, the first four sentences of paragraph 58, paragraphs 59 to 65 (but not necessarily for the completeness of all of the statements contained therein), 67, and paragraphs 70 to 72 (but not necessarily for the completeness of the statements contained therein) of the statement of claim.

2. PwC has no knowledge of the allegations contained in paragraphs 16, 17, 18, 32, 33, 34 and 35 of the statement of claim.

3. Except as hereinafter expressly admitted, PwC denies the remaining allegations in the statement of claim and puts the plaintiffs to the strict proof thereof.

B. OVERVIEW

4. This action arises out of one of the largest and longest running "Ponzi" schemes in history. The fraud, masterminded by Bernard L. Madoff ("**Madoff**"), was extraordinarily complex. It was designed to fool the most sophisticated investment professionals, investors, authorities, regulators, advisors and auditors, including auditors of the financial statements of funds, such as the plaintiffs, which entrusted assets to Bernard L. Madoff Investment Securities LLC ("**BLMIS**").

5. Madoff was so successful that his collusive fraud was only revealed on December 10, 2008 by his own confession. On that date, Madoff admitted to his two sons that his investment business was, and had been for at least 20 years, a massive Ponzi scheme and that there were essentially no assets behind the customer statements that reflected some $64 billion held in investors' accounts. Madoff's sons immediately reported him to the authorities. Whether

one or more of Madoff's sons were previously aware of the Ponzi scheme, or participated in it, is not known to PwC.

6. The following day, on December 11, 2008, Madoff was arrested on criminal charges that he violated federal securities laws. Thereafter, the United States Attorney for the Southern District of New York filed criminal charges. On March 12, 2009 Madoff pled guilty to all 11 charges including: (a) securities fraud; (b) investment adviser fraud; (c) mail fraud; (d) wire fraud; (e) international money laundering to promote unlawful activity; (f) international money laundering to conceal and disguise the proceeds of unlawful activities; (g) money laundering; (h) false statements to the government authorities; (i) perjury; (j) false filing with the SEC; and (k) theft from the employee benefit plan. Madoff is currently serving a 150-year prison sentence for fraud.

7. Like all Ponzi schemes, the Madoff fraud depended on providing reliable and attractive returns to investors by securing sufficient funds from new investors to cover redemption requests by existing investors. Madoff accomplished this goal by providing steady and positive, but not excessive, returns to bring in new money (all the while maintaining an aura of exclusivity). He perpetrated his scheme in part through several independently managed hedge funds, including using the various Fairfield Funds (defined below), which insulated him from direct contact with many of the individuals who ultimately contributed money to his scheme. Madoff was so successful, and the legitimacy of the business so seemingly real, that he deceived all regulatory bodies, including the U.S. Securities and Exchange Commission (the "**SEC**"), which conducted numerous investigations -- some after being told that Madoff was running a fraudulent enterprise -- yet failed to uncover the scheme.

8. Madoff knew that funds investing billions of dollars in BLMIS would be subject to scrutiny and that the funds would engage financial statement auditors to audit the funds' financial statements. As such, Madoff carefully structured his operations, with the collusion and cooperation of many others, to avoid detection not only by investigators and regulators, but also, by auditors of the financial statements of the funds as well.

9. Importantly for the purposes of this action, the underlying fraud was perpetrated by BLMIS. PwC was not engaged to audit BLMIS, but was retained by members of the Fairfield Greenwich Group, as agents and/or managers of Fairfield Sentry Limited ("**Fairfield Sentry**"), Fairfield Sigma Limited ("**Fairfield Sigma**") and Fairfield Lambda Limited ("**Fairfield Lambda**") (collectively the "**Fairfield Funds**") to audit the financial statements of the Fairfield Funds.

10. PwC therefore did not audit the entity through which the fraud was perpetrated. PwC was never retained to perform any work for Madoff, BLMIS or any other Madoff-related entity. Rather, PwC audited the financial statements of Fairfield Sentry which, in turn, entrusted assets with BLMIS and also audited the financial statements of Fairfield Sigma and Fairfield Lambda which, in turn, invested in Fairfield Sentry.

11. Further, and while the Madoff fraud was complex and of long standing, if anyone had the ability to discover the fraud, it was persons and/or organizations with far greater contact and access (or potential contact and access) with Madoff and/or BLMIS, such as, the Fairfield Principals and Fairfield Entities (defined respectively in paragraphs 16 and 37 below). By contrast, PwC was only engaged late in the day to audit the financial statements of the Fairfield Funds as at December 31, 2006 and December 31, 2007.

12. PwC duly and properly carried out its work and performed its audits in accordance with the terms of its engagement letters and in accordance with generally accepted auditing standards ("**U.S. GAAS**") applicable to the 2006 and 2007 audits.

13. Given the sophistication of the fraud (which was designed to deceive, and did deceive, fund managers, investment professionals, investors, advisors, regulators and others), PwC could not reasonably have been expected to detect the fraud in the course of its audit work, especially having regard to the limited timeframe of the engagements. But, the fact that PwC did not discover the fraud which took place at a third party and not at PwC's client does not mean that PwC was negligent or that it failed to meet the applicable audit standards. Rather, it means that PwC was deceived by Madoff, like everyone else, including other professional accounting firms faced with similar audits.

14. Indeed, and as pleaded above, the fraud was so successful that it was not discovered by anyone. It was only revealed by Madoff himself, when the unprecedented market decline in late 2008 forced Madoff to confess by reason of his inability to meet redemption requests.

C. THE PARTIES

(a) Background

15. The Fairfield Greenwich Group ("**FGG**"), was a collection of entities under common ownership that worked to issue and manage a number of investment funds, including some that directly or indirectly entrusted their assets to BLMIS. FGG billed itself as one of the world's largest alternative asset managers, with over $15.5 billion in assets under management. FGG operated through a number of different entities, including:

(i) Fairfield Greenwich Limited;

(ii) Fairfield Greenwich (Bermuda) Ltd.; and

(iii) Fairfield Greenwich Advisors LLC.

16. Hereafter, FGG and the various Fairfield entities pleaded in paragraph 15 above are collectively referred to as the "**Fairfield Entities**".

17. FGG was started in 1983 by its original partners, Walter M. Noel Jr., and Jeffrey Tucker. In 2007, Andres Piedrahita, who became a principal and partner of FGG in 1997, was named a "founding" partner of FGG. All of these individuals had extensive experience in the investment industry and impressive backgrounds which lent credibility to FGG and to the Fairfield Entities.

18. FGG began its relationship with Madoff in approximately 1990, when Jeffrey Tucker and another founding partner of FGG, Fred Kolber, introduced Walter M. Noel Jr. to Madoff. Shortly thereafter, FGG launched the Fairfield Sentry Limited fund ("**Fairfield Sentry**") and the Greenwich Sentry, L.P. fund ("**Greenwich Sentry**"). FGG used Madoff to execute the "split-strike conversion" ("**SSC**") strategy, pursuant to which BLMIS supposedly employed a proprietary model that dictated the timing for "buying a basket of equities hedged by puts and calls" designed to replicate the broadly positive returns on the S&P 100 stocks with reduced volatility.

(b) The Plaintiffs -- The Fairfield Funds

19. Fairfield Sentry was incorporated in 1990 as an international business company under the laws of the British Virgin Islands ("**BVI**"). Fairfield Sentry was the largest of the FGG funds, accumulating billions of dollars in reported assets prior to 2006. Its assets were valued at

approximately $6.2 billion at the end of 2006 and $7.3 billion at the end of 2007. Substantially all (approximately 95%) of these assets were purportedly held in segregated accounts at BLMIS, which purported to buy and sell stocks, treasury bills, and options for Fairfield Sentry's account in accordance with the SSC strategy.

20. Fairfield Sigma, another BVI entity, was incorporated in 1997 in furtherance of FGG's global expansion. Fairfield Sigma was a "feeder fund" which invested solely in Fairfield Sentry. It was a euro-denominated fund and its purpose was to allow investors to participate in Fairfield Sentry without taking on the risk of currency fluctuations between the euro and the U.S. dollar. It purported to have assets under management of approximately $651 million at the end of 2006 and $1.141 billion at the end of 2007.

21. Fairfield Lambda, another BVI entity, was incorporated in late 1990. Fairfield Lambda, like Fairfield Sigma, was a feeder fund that invested solely in Fairfield Sentry, but its currency was the Swiss franc rather than the euro. It purported to have assets under management of approximately $34 million at the end of 2006 and $38 million at the end of 2007.

22. Investment in the Fairfield Funds was limited to individuals who were not citizens or residents or the United States and entities not subject to US taxation. The minimum investment was $100,000 and investors were required to have a minimum net worth of $1,000,000. In addition, the Private Placement Memoranda for Fairfield Sentry, which applied to all Fairfield Funds, cautioned prospective purchasers that:

(a) the shares [of the fund] could only be held by persons who are "professional investors" within the meaning of the BVI Act and the Irish Stock Exchange;

(b) that all prospective purchasers of Shares [in the fund] must have the ability to speculate in "high risk securities"; and

(c) that substantially all of the Fairfield Funds' assets would be held in segregated accounts at BLMIS and that BLMIS would be a sub-custodian of all of the Fairfield Funds.

(c) The Fairfield Entities

23. Fairfield Greenwich Limited ("**FGL**") is a company incorporated under the laws of the Cayman Islands. FGL is a member of the National Futures Association, and is registered with the Commodity Futures Trading Commission as a commodity pool operator. FGL was held out and marketed as a member and partner of FGG. FGL was the Placement Agent for Fairfield Sentry, and oversaw the marketing of Fairfield Sentry's shares. Prior to 2003, FGL served as the Investment Manager of Fairfield Sentry and exercised broad discretion and control over Fairfield Sentry's assets.

24. Fairfield Greenwich (Bermuda) Ltd. ("**FGBL**") is an SEC-registered, exempted corporation organized under the laws of Bermuda which was incorporated on June 13, 2003. FGBL is a wholly-owned subsidiary of FGL and was marketed as a member and partner of FGG. FGBL is registered with the SEC as an investment advisor.

25. Commencing in 2003, FGBL was the Investment Manager for Fairfield Sentry, Fairfield Sigma and Fairfield Lambda. FGBL exercised broad discretion in the management of the investment activities of Fairfield Funds, the selection and monitoring of their investments, and maintaining relationships between the fund and respective escrow agents, custodians, sub-custodians, administrators, registrars and transfer agents. FGBL was responsible for reviewing

and approving the parameters and operating guidelines of Madoff's purported SSC strategy, conducting investment oversight, evaluating market risk, and monitoring investment compliance.

26. Fairfield Greenwich Advisors LLC ("**FGA**") is a Delaware limited liability company, incorporated on December 12, 2001. FGA was held out as a member and partner of FGG. FGA assisted FGBL with its fund manager selection and due diligence process, and provided each of the Fairfield Funds with administrative services and back-office support. FGA is registered with the SEC as an investment advisor.

(d) Legal Structure of the Fairfield Entities

27. The Fairfield Principals (defined below), Fairfield Entities and Fairfield Funds shared information, or had access to each other's information, and operated collectively as a partnership and as partners or agents of one another. The Fairfield Principals, Fairfield Entities and Fairfield Funds, intended to act as partners and agents of one another, held themselves out to investors as partners and conducted business as partners and agents under various names without regard to corporate structure and formalities. Their collective goal, amongst others, was to attract investment into funds operated by the Fairfield Entities, including the Fairfield Funds.

28. PwC pleads that the knowledge of any one or more of the Fairfield Principals or Fairfield Entities, including their agents, employees and representatives, was known or is deemed to have been known, as a matter of law, by the other Fairfield Principals and Fairfield Entities given their relationship as partners and agents of one another. PwC further pleads that all knowledge of the Fairfield Principals and/or Fairfield Entities, or any one or more of them, must be imparted to the Fairfield Funds.

29. Additionally, one or more of the Fairfield Principals and Fairfield Entities managed, or oversaw the management of, the Fairfield Funds. Further, any acts or omissions of those persons or entities is attributable to the Fairfield Funds.

(e) The Principals of the Fairfield Entities

30. Walter M. Noel, Jr. ("**Noel**") was a Founding Partner of FGG. Since founding FGG, Noel has been a director or general partner of a variety of FGG funds, including the Fairfield Funds, and oversaw all of FGG's activities. He had significant discretion and control over assets of the Fairfield Funds, among others. As a founding partner and senior officer of FGG, Noel was compensated with placement, management, and performance fees derived from investments with BLMIS.

31. Jeffrey H. Tucker ("**Tucker**") was a Founding Partner of FGG. In or about 1990, Tucker introduced Madoff to FGG. At all relevant times, Tucker oversaw the business and operations of several FGG management companies and funds. He had significant discretion and control over assets of the Fairfield Funds, among others. As a founding partner and senior officer of FGG, Tucker was compensated with placement, management, and performance fees derived from investments with BLMIS.

32. Andres Piedrahita ("**Piedrahita**") is one of Noel's sons-in-law. He too is a Founding Partner of FGG. He was a Director and President of FGBL, which in turn, was the investment manager of the Fairfield Funds. Piedrahita had overall management responsibility over FGG and was directly involved in its decision-making. He had significant discretion and control over assets of the Fairfield Funds, among others. As a founding partner and senior

officer of FGG, Piedrahita was compensated with placement, management, and performance fees derived from investments with BLMIS.

33. Amit Vijayvergiya ("**Vijayvergiya**") was a partner in FGG and served as the firm's Chief Risk Officer and President of FGBL. Vijayvergiya worked primarily out of FGG's Bermuda office, focusing on manager selection and risk management. Vijayvergiya had direct responsibility for monitoring and assessing the past and ongoing performance of FGG's assets, including assets of the Fairfield Funds entrusted to BLMIS. He had significant discretion and control over assets in the Fairfield Funds, among others. As a partner and senior officer of FGG, Vijayvergiya was compensated with placement, management, and performance fees derived from investments with BLMIS.

34. Daniel E. Lipton ("**Lipton**") was FGG's Chief Financial Officer, based in the New York office and a partner in FGG's Operations Group. He had significant discretion and control over assets in the Fairfield Funds, among others. As a partner and senior officer of FGG, Lipton was compensated with placement, management and performance fees derived from investments with BLMIS.

35. Mark McKeefry ("**McKeefry**") was FGG's Chief Operating Officer and General Counsel, based in New York and a partner in FGG's Operations Group. He had significant discretion and control over assets in the Fairfield Funds, among others. As a partner and senior officer of FGG, McKeefry was paid placement, management and performance fees derived from investments with BLMIS.

36. Jan R. Naess ("**Naess**") and Peter P. Schmid ("**Schmid**"), together with Noel, were, at all materials times, directors of the Fairfield Funds. These three individuals, as directors, were involved in the overall management of the Fairfield Funds, including establishing investment, dividend and distribution policies, and having authority to select and replace administrators, registrars, transfer agents, custodians and officers.

37. Hereafter, the directors, senior officers and partners pleaded in paragraphs 30 to 36 above are collectively referred to as the "**Fairfield Principals**".

38. As directors, senior officers and partners, the Fairfield Principals, in exercising their powers and discharging their duties, were obligated to act diligently, honestly and in good faith with a view to the best interests of the Fairfield Entities and Fairfield Funds and to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

39. As set out above, the Madoff fraud was complex and of long standing. It was designed to deceive investors, investment managers, regulators and others. Nonetheless, if anyone had the ability to discover the fraud, it was persons and/or organizations with far greater contact over an extended period of time, and access (or potential access) to Madoff and/or BLMIS, or related entities, such as the Fairfield Principals, Fairfield Entities and Fairfield Funds, including their agents, employees or representatives, or one or more of them.

40. Accordingly, PwC asserts that, to the extent the fraud could have been detected, the Fairfield Principals, Fairfield Entities or Fairfield Funds, or one or more them, were in a better position to detect the fraud, and to do so at an early stage. The pleas of breach of contract

(in relation to FGBL and FGL) and negligence set out hereunder against the Fairfield Principals and Fairfield Entities, or one or more of them, are advanced on the basis that those entities (whose acts and/or omissions are attributable to the Fairfield Funds) and their claims against PwC cannot succeed when they themselves failed to detect the fraud through their own breaches of contract and/or negligence.

41. As more particularly pleaded below, the Fairfield Principals, either alone or in conjunction with the Fairfield Entities and for and on behalf of the Fairfield Funds, failed to conduct appropriate due diligence and failed to monitor the investments at BLMIS. In addition, or in the alternative, the Fairfield Principals failed to cause the Fairfield Entities, particularly FGL and FGBL, to fulfill their obligations to the Fairfield Funds.

(f) The Defendants

42. PwC is an Ontario limited liability partnership which carries on business throughout Canada as a national audit and accounting firm.

43. Stephen W. Wall served as the engagement partner for PwC's audits of the Fairfield Funds. Mr. Wall is a partner in the PwC AAG (Audit) Toronto Financial Services Group specializing in the Investment Management practice. At the time of the first Fairfield audit in 2006, Mr. Wall had over 20 years experience. Mr. Wall leads the PwC Canadian Broker Dealer Practice and is the firm member and former chair of the Investment Industry Regulatory Organization of Canada Panel Auditors Committee.

(g) Bernard L. Madoff

44. Bernard L. Madoff, was, prior to his arrest, a well-respected innovative broker/dealer who had served three stints as head of the NASDAQ stock exchange.

(h) Bernard L. Madoff Investment Securities, LLC

45. BLMIS was an SEC-registered broker-dealer with its principal place of business in New York.

46. BLMIS's investment advisory service, whose clients included some direct investors but also several large hedge funds such as the Fairfield Funds, purported to buy and sell securities for each client's segregated account in accordance with the SSC strategy. Investors, such as the Fairfield Funds received monthly statements (the large funds even received individual trade tickets) showing purchases and sales for the investor's account, all of which reflected what appeared to be actual transactions.

(i) Citco Financial Services Group

47. FGG did not provide administrative services for its funds on a day-to-day basis. These services, including all internal accounting and custody services, were provided by companies that specialized in providing such services. FGG retained entities in the Citco Financial Services Group ("**Citco**") to provide administrative and custody services for the Fairfield Funds and for other FGG funds with assets held by BLMIS. This work was performed by, and was the responsibility of, Citco entities in Europe and Canada which included Citco Fund Services (Europe) B.V. ("**Citco Europe**"), Citco Global Custody N.V. ("**Citco Global**"), Citco Bank Nederland N.V., Dublin Branch ("**Citco Dublin**") and Citco (Canada), Inc. (Toronto) ("**Citco Canada**").

48. Prior to the fall of 2006, Citco Europe, located in Amsterdam, served as Fairfield Sentry's administrator. In that role, and as more particularly set out below, Citco Europe had the responsibility for providing the day-to-day administrative services which included, among other things, maintaining the books and records of the Fairfield Funds, preparing reports and accounts, calculating net asset value and fees, preparing the communications with shareholders and/or governmental bodies, paying expenses and preparing monthly financial statements.

49. In late 2006, Citco Europe delegated the provision of administrative services for Fairfield Sentry to Citco Canada. This change in location of the third-party administrator for the Fairfield Funds prompted FGG to retain PwC in Canada as the independent auditor for the Fairfield Funds' financial statements.

50. Aside from administrative services, Citco through other related entities, also provided custody services for the Fairfield Funds. Citco Dublin was the "Custodian" for the Fairfield Funds and Citco Global was the "Depositary". Citco Dublin was responsible for providing custody services i.e. settling transactions on behalf of the Fairfield Funds, delivering or receiving securities, registering securities and making or receiving payments for the Fairfield Funds. Citco Dublin was also responsible for maintaining an appropriate level of supervision over sub-custodians (i.e. BLMIS) and making appropriate enquiries, periodically, to confirm that the obligations of BLMIS were being competently discharged.

51. PwC pleads, and relies upon, all of the terms of the Custodian Agreement, and any and all related agreements, between or among Fairfield Sentry, Citco Dublin and Citco Global as to the duties and responsibilities of those entities.

D. THE MADOFF FRAUD

52. At any given point in time, the Fairfield Funds believed they owned a certain number of shares, T-bills, and/or option contracts held in their BLMIS accounts. Unbeknownst to the Fairfield Funds, the SEC, or the rest of the world, BLMIS was generating its transaction data after the fact, thus allowing it to manipulate the reported returns. It does not appear that BLMIS actually made any of the trades it reported to the Fairfield Funds (or to many others) for some twenty (20) years prior to 2008. Yet, BLMIS honoured investors' requests for redemptions year-in and year-out.

53. The Madoff fraud was extraordinarily complex and involved the participation and collusion of many others. In addition to Madoff, other key individuals were critical to the success of the fraud. They included:

(a) Frank DiPascali, ("**DiPascali**") a senior BLMIS official who had worked for Madoff since he was 19 years old and oversaw the day-to-day operations of BLMIS;

(b) Jerome O'Hara and George Perez, two computer programmers who developed the programs used to generate vast amounts of fake data to perpetrate the fraud;

(c) Daniel Bonventre, the Director of Operations at BLMIS for over 30 years, who was responsible for managing bank and brokerage accounts, clearing and settlement functions, accounts and stock records, and the general ledger, financial statements and related books and records for BLMIS' operations; and

(d) Joann "Jodi" Krupi and Annette Bongiorno, both "back office" supervisors who assisted in the day-to-day operations of the scheme.

54. It is now apparent that Madoff also sustained his scheme by conspiring, or otherwise working with, the assistance of his own auditor, David G. Friehling ("**Friehling**") of Friehling & Horowitz. Although Friehling purported to conduct an audit of BLMIS, it appears (based on US regulatory and criminal investigations) that he failed to do so and that he only took sufficient steps to dupe regulators and auditors, such as PwC.

55. Although PwC does not have direct knowledge of the regulatory and criminal charges brought against Friehling, it accepts as generally correct the allegations in paragraphs 70, 71 and 72 of the statement of claim, including Friehling's guilty plea to nine criminal charges.

56. PwC does not yet have particulars, or production, with respect to the numerous regulatory and criminal investigations and/or charges and may amend/supplement its defence upon receipt thereof.

E. THE PWC AUDIT ENGAGEMENTS

(a) Background

57. This action was commenced on May 28, 2012 more than four (4) years after Madoff's admission on December 10, 2008 that his business was, and had been for years, a massive Ponzi scheme. The statement of claim therefore was drafted years after the fact, with the benefit of a wealth of information (garnered through a multitude of criminal and regulatory investigations) that was not available to the public, to U.S. regulators or to PwC.

58. The statement of claim unreasonably criticizes PwC based on information only disclosed after Madoff's admission of guilt and with the benefit of 20/20 hindsight. PwC, as an auditor of the Fairfield Funds for only two years, is now criticized for having failed to detect a

remarkably complex and collusive fraud which FGG, the Fairfield Entities, Citco, the SEC (which had significant investigative panel) and many others (including auditors of all the funds holding the Madoff investments for over 20 years) failed to discover for more than 20 years. What lead to Madoff's downfall was a severe market collapse in 2008 which left him running a Ponzi scheme with insufficient assets from new investors to keep the scheme afloat.

59. Madoff's elaborate deceptions had successfully fooled sophisticated US regulators despite several rounds of scrutiny. Without being exhaustive, they include:

(a) a 2004 SEC investigation that was initiated by the suspicion that BLMIS was "front-running" i.e. placing orders for favoured clients ahead of others to get a better price. The examination was part of an investigation by the SEC's Office of Compliance Inspections and Examinations ("**OCIE**") which had been triggered by complaints by a hedge-fund manager who "...couldn't understand how [Madoff] was maintaining his performance" and "couldn't figure out how he was...earning returns";

Notwithstanding the OCIE investigation, the SEC did not discover Madoff's fraud.

(b) a second SEC examination in 2005 which found no fault with BLMIS except that it had not, but should have, registered as an investment advisor. Part of this investigation led to a lengthy review of BLMIS' operations by the SEC's Northeast Regional Office, with near-daily contact with Madoff himself. Again, Madoff's scheme evaded detection;

(c) in July, 2005 the Financial Industry Regulatory Authority ("**FINRA**") conducted an investigation of Madoff that led to a censure and a $7,000.00 fine for "limit-order display violations". Again, despite this investigation, neither the fraud nor any other misconduct was detected; and

(d) in 2006, the SEC undertook another investigation of BLMIS in response to a complaint filed by Harry Markopolous, who thought that Madoff was running a Ponzi scheme. Again, and despite having been put on notice of the very Ponzi-scheme which led to Madoff's demise, the fraud was not detected by the SEC.

60. Further, and in the context of the significant losses that accrued for the multitude of investments held by BLMIS, not one sophisticated and reputable financial institution (including, Royal Bank of Canada and Royal Bank of Scotland) detected the fraud. Indeed, Canadian firms, HSBC Securities and TD Securities, advised clients to invest in a related fund, Tremont Funds, which reportedly had over $3 billion in assets. RBC Dominion Securities and Mackenzie Financial also had several clients that were invested in funds with assets purportedly held by BLMIS.

61. Finally, a multitude of respected accounting firms, across many jurisdictions, audited the financial statements of funds similar to the plaintiff funds. These firms included, amongst others, BDO Seidman, Ernst & Young, KPMG and a number of smaller audit firms. None of those firms detected the fraud over 20 or more years.

62. It is PwC's position that it met all of its obligations. It breached no duties to anyone. Further, when considering the plaintiffs' allegations one must consider the information concerning Madoff and BLMIS known at the time and the audit standards that were, in fact, generally accepted and applicable to the 2006 and 2007 audits.

(b) The Engagement Letters

63. Pursuant to written engagement letters, FGG, as agent for the Fairfield Funds, engaged PwC to audit the annual financial statements of the Fairfield Funds (i.e. the financial

statement of each of Fairfield Sentry, Fairfield Sigma and Fairfield Lambda) as at December 31, 2006 and December 31, 2007. The audits were governed by, and subject to, written engagement letters between FGG and PwC.

64. The engagement letter for the 2006 audit is dated January 11, 2007 (the "**2006 Engagement Letter**") and the engagement letter for the 2007 audit is dated October 17, 2007 (the "**2007 Engagement Letter**"). Both the 2006 Engagement Letter and the 2007 Engagement Letter (collectively the "**Engagement Letters**") were signed by Lipton as a partner and Chief Financial Officer of FGG. The Engagement Letters set out the scope of PwC's obligations to the Fairfield Funds.

65. As to the prevailing, and generally accepted standard, PwC denies having held itself out as auditing, or having any requirement to audit, to a standard other than that required by U.S. GAAS, as alleged in paragraphs 75, 92, and 107 of the statement of claim. PwC made no such representation and the Fairfield Funds had no expectation otherwise.

66. The Engagement Letters contain several provisions relevant to assessing the engagement team's responsibilities with regard to the issues raised in this action. As is customary, they required the team to obtain reasonable, but not absolute, assurance that the financial statements of the Fairfield Funds were free of material misstatement:

> The objective of a financial statement audit is the expression of an opinion on the financial statements. We will be responsible for performing the audit in accordance with generally accepted auditing standards in the United States of America. These standards require that we ***plan and perform the audit to attain reasonable assurance whether the financial statements are free of material misstatement***. The audit will include examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing

> accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. (emphasis added)

67. With regard to "Internal Control, Fraud and Error," the Engagement Letters stated that PwC's review of the internal controls would not be sufficient to allow PwC to render an opinion on the effectiveness of those internal controls, nor would it be able to identify all significant weaknesses in the fund's internal controls:

> We will consider the Funds' internal control over financial reporting solely for the purpose of determining the nature, timing and extent of auditing procedures necessary for expressing our opinion on the financial statements. ***This consideration will not be sufficient to enable us to render an opinion on the effectiveness of internal control over financial reporting nor to identify all significant weaknesses in the Funds' system of internal financial controls.*** However, we will inform the appropriate level of management and the Board of Directors of any significant weaknesses in internal control that come to our attention. (emphasis added)

68. The Engagement Letters expressly note that that there could be no absolute assurance that the audit would detect fraud or illegal acts:

> "Because of the inherent limitations of internal control over financial reporting, including the possibility of management override of controls, ***misstatements due to error or fraud may occur and not be detected.***
>
> We will design our audit to provide reasonable, but not absolute, assurance of detecting errors or fraud that would have a material effect on the financial statements as well as other illegal acts having a direct and material effect on financial statement amounts. Our audit will not include a detailed audit of transactions, such as would be necessary to disclose errors or fraud that did not cause a material misstatement of the financial statements.
>
> ***It is important to recognize that there are inherent limitations in the auditing process. Audits are based on the concept of selective testing of the data underlying of financial statements, which involves judgment regarding the areas to be tested and the nature, timing, extent and results of the tests to be performed. Audits are, therefore, subject to the limitation that materials errors or fraud or other illegal acts having a direct and material financial statement impact, if any exist, may not be detected.*** Because of the characteristics of fraud, particularly those involving concealment through collusion, falsified

> documentation and management's ability to override controls, ***an audit designed and executed in accordance with generally accepted auditing standards in the United States of America may not detect a material fraud***. Further, while effective internal control reduces the likelihood that errors, fraud or other illegal acts will occur and remain undetected, it does not eliminate that possibility. For these reasons, ***we cannot ensure that errors, fraud or other illegal acts, if present, will be detected***. (emphasis added)

69. The Engagement Letters made clear that the responsibility for the prevention and detection of fraud rested with the management of the Fairfield Funds:

> Management also is responsible for the design and implementation of programs and controls to prevent and detect fraud, and for informing us (i) about all known or suspected fraud affecting the Funds involving (a) management, (b) employees who have significant roles in internal control over financial reporting, and (c) others where the fraud could have a nontrivial effect on the financial statements; and (ii) of its knowledge of any allegations of fraud or suspected fraud affecting the entity received in communications from employees, former employees, analysts, regulators, investors or others. In addition, management is responsible for identifying and ensuring that the Funds comply with the laws and regulations applicable to its activities.

70. Nothing in the Engagement Letters assigned to PwC the responsibility for preventing or detecting a complex and collusive fraud perpetrated on the Fairfield Funds, and others, by third parties, such as Madoff and BLMIS.

(c) Scope of PwC's Responsibilities

71. As set out above, PwC was not retained to audit, and did not audit, BLMIS or any other Madoff-related entity. As such, and even though an auditor may detect fraud in the course of a financial statement audit of the entity being audited, it is far more remote and less likely for an auditor to detect fraud in a third party, such as BLMIS.

72. Indeed, the Engagement Letters and representation letters (defined below) did not foresee or contemplate PwC detecting fraud in any entity other than possibly the FGG funds

being audited, including the Fairfield Funds. Further, as concerns the FGG funds, including the Fairfield Funds, PwC was only obligated to design its audit procedures to provide reasonable, but not absolute, assurance of detecting fraud.

73. It is important to recognize the inherent limitations of the audit process. Audits are based on selective testing which involves judgment based on the auditor's knowledge of the entity, the areas to be tested and the nature, timing, extent and results of the tests to be performed. Audits are, therefore, subject to the limitation that material errors or fraud or other illegal acts may not be detected.

74. It was the responsibility of the management of FGG and/or the Fairfield Funds to prepare the financial statements of each of the Fairfield Funds on an annual basis and to provide those statements to PwC for audit. In each of 2006 and 2007 management prepared the financial statements and represented to PwC that the statements presented fairly, in all material respects, the financial position of the Fairfield Funds, among others.

(d) Client Acceptance

75. Upon taking on the 2006 audit, PwC neither treated FGG or the Fairfield Funds as "continuing" clients of the firm, nor did it conduct less rigorous client acceptance procedures as alleged in paragraph 38 of the statement of claim. Rather, and in accordance with its duties as a continuing auditor, PwC secured and reviewed the 2005 file of PwC Netherlands and took appropriate steps to familiarize itself with the Fairfield Funds, and the auditing environment, including internal controls, as required.

76. The Fairfield Funds also refer to PwC as one firm which is incorrect and misleading. The Canadian partnership of PwC is separate and distinct from the PwC partnership in the Netherlands. Similarly, and just as the Canadian and Netherlands firms are distinct legal entities, so too is PricewaterhouseCoopers International Limited ("**PwCI**"). While PwCI does play a role in issuing standards for member firms (though not specific audit standards, which are issued by regulatory entities in various jurisdictions), PwCI does not provide auditing and accounting services and member firms operate independently of one another.

F. PWC AND WALL COMPLIED WITH GENERALLY ACCEPTED AUDIT STANDARDS APPLICABLE TO THE 2006 AND 2007 AUDITS

77. PwC denies the allegations of breach of contract, negligence and breach of duty pleaded in paragraphs 104 through 112 of the statement of claim. PwC further denies that the Fairfield Funds have accurately pleaded the applicable GAAP, GAAS and IFRS standards or that PwC was subject to higher standards by reason of its audit manuals or those of PwCI. PwC duly and properly carried out its work and performed the audits in accordance with the terms of the Engagement Letters and with U.S. GAAS applicable to the 2006 and 2007 audits.

78. PwC pleads and relies upon U.S. GAAS generally, the practice in the profession generally and the auditing standards ("**AU**") of the American Institute of Certified Public Accountants ("**AICPA**") applicable to the 2006 and 2007 audits including, without limitation, AU 110, 230, 312, 314, 316, 324, 326, 330, 332, 9332 and the AICPA Audit and Accounting Guide.

79. PwC disclosed to FGG and to the Fairfield Funds the inherent limitations of the audit process (based on selective testing) and its audit opinion, to the knowledge of FGG and the

Fairfield Funds, did not constitute a guarantee that the financial statements would not contain material misstatements. The subsequent discovery of a material misstatement does not establish that PwC failed to meet its professional obligations or that it fell below the applicable standard. Any such failure is vigorously denied and PwC puts FGG and the Fairfield Funds to the strict proof thereof.

80. Indeed, U.S. GAAS expressly recognizes that a properly performed financial statement audit will not necessarily detect fraud causing a material misstatement. In particular:

(a) AU 316.12 provides, in part, that "even a properly planned and performed audit may not detect a material misstatement resulting from fraud. A material misstatement may not be detected because of the nature of audit evidence or because the characteristics of fraud as discussed above may cause the auditor to rely unknowingly on audit evidence that appears to be valid, but is, in fact, false and fraudulent";

(b) AU 316.31 provides, in part, that "[b]ecause fraud is usually concealed, material misstatements due to fraud are difficult to detect"; and

(c) AU 110.02 provides, in part, that "[b]ecause of the nature of audit evidence and the characteristics of fraud, the auditor is able to obtain reasonable, but not absolute, assurance that material misstatements are detected."

81. Further, the standards speak to potential fraud at the audit client. The applicable auditing standards enumerating the fraud "risk factors", of which an auditor should be aware, emphasize the conditions and factors applicable to management and employees of the audited entity. Where the standards recognize the possibility that a third party may be involved in a fraud, they do so by focusing on situations where management may perpetrate a fraud with the help of third parties.

82. In this case, the highly sophisticated and collusive fraud was perpetrated by Madoff, at BLMIS, with the involvement of numerous individuals. PwC did not audit BLMIS and PwC did not detect, nor can it be criticized for not having detected, a collusive fraud at a third party which numerous individuals were at pains to hide.

(a) The Audit Plan

83. In both 2006 and 2007 PwC developed and carried out the audit work pursuant to a detailed audit plan in accordance with the requirement of U.S. GAAS. PwC planned its audit work based on its understanding of the operations of the Fairfield Funds, Citco and BLMIS, and on knowledge obtained as auditor of the Fairfield Funds. The members of the audit teams had the requisite skills and experience and were knowledgeable regarding the accounting issues and auditing procedures relevant to the Fairfield Funds.

84. In carrying out the audit work, PwC reasonably relied on the information provided by management. In particular, and as required by U.S. GAAS, namely, AU 316.20 to 316.27, PwC made inquiries of management regarding the risks of material misstatement, including fraud as follows:

(a) in connection with the 2006 audit, PwC administered a "Fraud and Error" questionnaire for which it received an entirely acceptable response from FGG's Controller. The response indicated, among other things, that FGG had "no knowledge of any actual, suspected or alleged fraud affecting the entity". The response provided also described the mechanisms in place at FGG to evaluate fraud risks and to establish appropriate controls; and

(b) in connection with the 2007 audit, PwC discussed fraud issues with FGG's Chief Financial Officer, Lipton, Controller Nancy Ng, and Franklin Mejia of FGG at a meeting held on October 17, 2007. Those individuals again reported that the fraud risk was low and no specific fraud risks were communicated to PwC; and

(c) at the completion of each audit, FGG's Representation Letters (as defined below) to PwC re-affirmed that management was responsible "for the design and implementation of programs and controls to provide reasonable assurance that fraud is prevented and detected," and that management had "no knowledge of any fraud or suspected fraud affecting the Fund involving: a. Management, b. Employees ..., or c. Others where the fraud could have a material effect on the financial statements."

(d) in a result, therefore, PwC raised issues concerning the potential risk of fraud with FGG and secured comfort, in both 2006 and 2007 (from FGG which had a long association and business relationship with BLMIS) that mechanisms were in place to evaluate fraud risk and that the risk of fraud was low.

(b) Understanding the Fairfield Funds and the Allegations that PwC Failed to understand the Entities Being Audited

85. PwC denies the allegations contained in paragraph 105 (f) of the statement of claim that it failed to understand the business of the Fairfield Funds. PwC responds as follows:

(a) in accordance with U.S. GAAS, and in particular AU 314.01, PwC gained an understanding of the Fairfield Funds and their operational and control environment. PwC did this through, among other things, meetings with representatives of FGG at the commencement of, and throughout, both the 2006 and 2007 audit process; and

(b) as concerns the allegations in sub-paragraphs 105 (f) (i) to (iii) of the statement of claim that PwC did not understand the SSC strategy and that FGG could not articulate how it worked, PwC reviewed the Fairfield Funds' offering memoranda which explained the strategy and PwC duly performed procedures designed to give audit comfort, and which gave audit comfort, that the Fairfield Funds' activity was consistent with the SSC strategy.

(c) Citco Canada and its Control Environment

86. PwC also took appropriate steps to gain an understanding of Citco Canada and its Control Environment. Citco Canada, as a service provider to a number of investment-management firms, obtained a report on the operation and effectiveness of its internal controls on an annual basis from Ernst & Young LLP U.S. ("**Citco Canada SAS 70 Report**"). Citco Canada provided this report to its clients that relied upon Citco Canada for the information contained in the clients' financial statements.

87. PwC obtained from Citco Canada, and reasonably relied upon, the Citco Canada SAS 70 reports prepared by E&Y for the 2006 and 2007 fiscal years. Those reports covered Citco Canada's regular receipt of information about the securities held at BLMIS and Citco Canada's reconciliation of that information with the information on the books and records of the Fairfield Funds.

88. Additionally, in each audit year, PwC had information technology specialists conduct a substantive "gap analysis," the purpose of which was to compare control expectations to those covered in the Citco Canada SAS 70 reports and to consider whether any additional control testing was warranted. Based on this work, the audit team concluded that the overall internal control framework appeared to be operating effectively and, thus the audit strategy, as communicated in the audit plan, was executed as planned.

89. Further, PwC reviewed the Citco Canada SAS 70 Reports not only to understand the internal controls in place at Citco Canada, but also, to obtain evidence of their effective

operation. The reports gave PwC comfort as to the information provided to it by Citco Canada, including, for example, its processing and reconciliation of information provided to Citco Canada by BLMIS with respect to transactions, valuation information, and resulting gains and losses.

(d) BLMIS, its Control Environment and the Service Organization Allegation

90. AU 324.02 provides that a "service organization" is an entity that "provides services" to an entity whose financial statements are being audited that "are part of the User Organization's information system". With respect to the allegations in paragraphs 86, 87 and 89 of the statement of claim, PwC states that BLMIS may only be considered to be a "service organization", within the meaning of the applicable standards, in a limited respect, and PwC was not required to characterize or label BLMIS as such.

91. To the extent that BLMIS may be considered to have been a service organization, within the meaning of the applicable standards, it was one only in respect of the initiation of trades and not with respect to the execution of securities transactions or its activities as sub-custodian of the securities of the Fairfield Funds. In this regard, AU 332.13 provides, in part, that "examples of a service organization's services that would not be a part of an entity's information system" include "[t]he holding of an entity's securities" and "[t]he execution by securities broker of trades that are initiated by either the entity or its investment advisor".

92. In any event, PwC complied with all potentially applicable standards. To the extent that BLMIS was a service organization for the initiation of trades (and to the extent that BLMIS was a service organization for the purpose of executing trades and holding of securities, which is denied), PwC did in fact gain an understanding of BLMIS' controls related to these

functions through, among other things, inquires of senior BLMIS personnel, as described below. Paragraph 9.27 of the AICPA Guide contemplates that an auditor can rely upon inquiries of the broker dealers and PwC duly made such inquiries. As detailed below, PwC also obtained evidence that the relevant controls related to these functions were operating effectively by obtaining from BLMIS copies of its auditors' reports on internal controls. Paragraph 9.28 of the AICPA Guide contemplates that an auditor can rely upon such evidence. Accordingly, to the extent that BLMIS was a service organization for any such purposes, PwC complied with the potentially applicable standards.

93. As set out below, PwC made inquiries of BLMIS. The inquiries made were appropriate and the answers received entirely satisfactory. The inquiries were designed to address, among other things, the control issues that might potentially impact the Fairfield Funds which had entrusted assets to BLMIS. The inquiries made of BLMIS tracked the issues recommended for consideration under potentially applicable standards, and gave PwC an appropriate understanding of the controls that might be relevant to any function performed by BLMIS which might qualify it as a service organization.

94. In this case, the following occurred, among other things:

(a) PwC Netherlands conducted the audit of the financial statements of the Fairfield Funds for the years ending December 31, 2005. With respect to the allegations contained in paragraphs 43 and 44 of the statement of claim, PwC did not rely upon the work of PwC Netherlands but reviewed its work in accordance with the standards applicable to communicating with and reviewing the work of a predecessor auditor;

(b) during the course of PwC's communications with PwC Netherlands, PwC learned that PwC Netherlands obtained information about BLMIS by means of an annual inquiry of BLMIS executed by a representative from PwC Bermuda (which audited funds with assets held at BLMIS) and a representative from PwC U.S. (which did not audit any funds with BLMIS investments) who specialized in broker-dealer audits. These inquiries were conducted via bi-annual site visits and in-person interviews with Madoff himself or other senior BLMIS officials and a review and update of the information via telephone conference in other years;

(c) in respect of the 2006 audit, PwC obtained and reviewed a memorandum documenting the visit to BLMIS by representatives of PwC Bermuda and PwC U.S. including an interview with Madoff. Topics covered at this meeting with Madoff included segregation of duties, security, controls over trading activity, internal audit, and fraud considerations. As noted below, PwC also obtained and reviewed from BLMIS (via PwC Bermuda) a current Report on Internal Controls and a current Statement of Financial Condition prepared by BLMIS' external auditor; and

(d) in respect of the 2007 audit, a representative of PwC Bermuda met by phone with BLMIS's Chief Financial Officer, DiPascali. DiPascali confirmed, in response to PwC's enquiries, that there were no significant changes from the information provided by Madoff in 2006. As noted below, PwC also obtained and reviewed from BLMIS (via PwC Bermuda) a current Report on Internal Controls and a current Statement of Financial Condition prepared by BLMIS' external auditor.

95. With regard to the risk that "[t]he recorded securities exist" (or do not exist, as was the case with BLMIS), paragraph 9.30 of the AICPA Guide recommends only that an auditor, such as PwC, having obtained the information referred to above: "Confirm with the broker-dealer the name of the investee, the number of shares, whether the shares are pledged, and that [the audit entity] is the owner." PwC took this step, among others.

96. With regard to the risk that the "[t]he recorded securities transactions occurred" (or did not occur), paragraph 9.30 of the AICPA Guide specifies only that the auditor, having obtained the information referred to above, should: "[i]nspect supporting documentation such as trade confirmations or entries in the broker-dealer's monthly statements." PwC took this step, among others, by reviewing, on a sample basis, trade confirmations and the BLMIS brokerage statements.

97. In summary, with respect to the service organization allegations, PwC complied with all applicable or potentially applicable audit standards in the circumstances.

(e) PwC Received Evidence that BLMIS Had Effective Operating Controls in Place and the allegations with respect to reliance on BLMIS's auditor

98. PwC denies the allegations contained in paragraph 105(p) of the statement of claim that PwC placed undue or unreasonable reliance on the reports of its independent auditor, Friehling & Horowitz ("**F&H**").

99. As noted above, in addition to the 2006 BLMIS visit and interview memorandum and 2007 follow-up memorandum, in both years, PwC also obtained and reviewed the audited statements of BLMIS and the reports of F&H on the internal controls at BLMIS. PwC inquired of the Chief Financial Officer of FGG, Lipton, as to F&H and was told that the firm was a competent niche auditor of broker-dealers. PwC reasonably relied upon this fundamental representation which was false and misleading.

100. F&H's reports in both years certified: "[W]e noted no matters involving internal control, including control activities for safeguarding securities, that we consider to be material weaknesses." Similarly, an auditor's report accompanied Madoff's statements of financial

condition. In both years, the auditor opined that "the statement of financial condition presents fairly, in all material respects, the financial position of Bernard L. Madoff Investment Securities LLC."

101. The reports on internal controls by F&H were required under U.S. federal securities regulations. The reports were prepared in accordance with SEC Rule 17a-5 and signed by F&H, as a certified public accountant. These documents were consistent with the assertions made by Fairfield Sentry as to the standing of BLMIS as a U.S. registered broker-dealer and qualified custodian. As an experienced auditor of broker-dealers, PwC was familiar with these reporting requirements and the audit work required to produce such reports. The reports provided by BLMIS were of the sort, and in the format, one would expect to see from a qualified independent auditor of a registered broker-dealer and therefore provided PwC with appropriate audit comfort.

102. With respect to paragraph 68 of the statement of claim, PwC did not act contrary to any disclaimer in the F&H reports. It was appropriate that PwC take these reports into account as evidence of the effective operation of certain controls at BLMIS, as represented by BLMIS. In short, BLMIS was entitled to use these reports for purposes such as responding to inquiries and providing information to third parties, which it did, and which PwC properly took into account in its assessment of the controls at BLMIS.

103. PwC did not rely on the work of F&H with respect any financial information or to confirm the custody or existence of the assets of the Fairfield Funds. The evidence of the existence of the assets was the confirmation provided by BLMIS and the fact that the other information obtained by PwC, including the reports prepared by F&H, were consistent with that

confirmation. This approach was entirely consistent with the audit standards prevailing at the time.

104. PwC did not know, and could not reasonably have known, that F&H, a professional accounting firm in good standing, was complicit with Madoff in perpetrating the fraud. PwC has now learned that Friehling pled guilty to securities law violations as pleaded in paragraphs 70 to 72 of the statement of claim.

(f) Reasonable Assurances as to the Existence of the Securities at Citco Dublin and BLMIS

105. In order to audit the schedule of investments in the financial statements of the Fairfield Funds at year end, PwC obtained a complete list of the Fairfield Funds' assets from Citco Canada in the form of a "Combined Portfolio" report. The Combined Portfolio reports reflected, consistent with the SSC strategy, that the Fairfield Funds were almost 100% invested in U.S. Treasury Bills and cash as of each December 31st. For instance, as of December 31, 2006, Fairfield Sentry reported that it held approximately $5.38 billion in Treasuries, $623 million in cash, and $180 million in other FGG funds.

106. In order to obtain assurance regarding the existence of these securities, PwC undertook to confirm each Fairfield Sentry security held by third-party custodians. The applicable standards, including AU 332.21, recognize that confirmation by the custodian of a security is an appropriate means of obtaining audit evidence of the existence of assets. PwC requested, and obtained, confirmations not on an aggregate basis but for specific securities on the financial statements. Accordingly, PwC sought and obtained confirmation from BLMIS of specific holdings on the books of the Fairfield Funds.

107. To confirm the holdings of the Fairfield Funds, the PwC audit team also obtained broker statements from BLMIS reflecting all securities held as of December 31st each year. The requests for confirmations were sent to BLMIS and were subsequently received and reviewed by PwC. The BLMIS statements were enclosed with a confirmation letter from DiPascali, the CFO of BLMIS, responding to the questions posed by PwC.

108. PwC also tested the market value for each security listed in the Combined Portfolio report by comparing the reported value to independent third-party sources. By example, PwC tested 100% of the securities held by Fairfield Sentry, in a number of different series of U.S. Treasuries, by comparing them to Bloomberg quotes. No significant differences were observed between the values as stated on the Combined Portfolio report and the values reported externally.

109. PwC received additional comfort as to the accuracy of the information provided by BLMIS in two further ways:

(a) the audit evidence PwC received through its confirmation process was consistent with the information that BLMIS had provided to Citco Canada several times throughout the year and that Citco Canada, an entirely independent party, had reconciled with its own records of the assets of Fairfield Sentry via a process confirmed as reliable by the Citco Canada SAS 70 Report prepared by E&Y;

(b) PwC also received information from Citco Dublin in its role as custodian (as opposed to sub-custodian) for the assets of Fairfield Sentry. Though PwC understood that BLMIS had actual physical custody of most of the assets of Fairfield Sentry, Citco Dublin was charged with supervising and ensuring the suitability of BLMIS to serve as a custodian of the Fairfield Sentry assets by its Custodian Agreement with FGG. Accordingly, while PwC obtained direct evidence from BLMIS confirming the existence of securities, PwC also received confirmations (with identical asset amounts and values) from Citco Dublin in response to the confirmations PwC sent to confirm assets for the various funds, which included some non-BLMIS held assets and some fund-to-fund investment assets, such as those of the Fairfield Sigma and Fairfield Lambda; and

(c) none of the Citco entities ever provided PwC with any information that would have caused PwC to doubt or question the information provided by BLMIS or by Citco Dublin.

(g) PwC Tested the Fund's Realized Gains and Losses

110. Part of PwC's audit plan was also to perform "transaction testing" on the trading executed by BLMIS. In 2006, this testing was performed as part of PwC's testing of realized gains and losses. First, PwC obtained a "Realized Gain/Loss per Lot Details" report from Citco for each of the Fairfield Funds. Second, the audit team selected 50 sample transactions from throughout the year to test, including 42 Fairfield Sentry transactions. Third, the audit team obtained supporting documentation from Citco. Finally, the audit team checked the trade details in the Citco report to the trade details in the broker statements and noted 100% agreement. The same testing was performed in 2007.

(h) The Alleged "Audit Warning Signs"

111. At paragraph 105(h)(i)-(viii) of the statement of claim, the Fairfield Funds criticize PwC for having failed to investigate alleged "Audit Warning Signs" which they say ought to have caused PwC to expand the scope of its audit work or to heighten its level of professional skepticism. These allegations, like others raised by the Fairfield Funds, are unfair as many of the alleged warning signs were generally known (and thus not warning signs at all),

or alternatively, are based on facts not known at the time and only now characterized as warning signs with the benefit of 20/20 hindsight. PwC responds to the alleged warning signs as follows:

(i) the fact that BLMIS was the sub-custodian, with other roles, was not a warning sign at all. The roles of BLMIS were disclosed in the private placement memoranda of all Fairfield Funds and known to all, including the Fairfield Principals and the Fairfield Entities;

(ii) the fact that BLMIS employed Madoff family members is similarly not an audit warning sign;

(iii) PwC denies that it was required to analyze the alleged trading by BLMIS, but in any event, whether or not PwC was obligated to conduct such analysis, the trading activities of BLMIS does not constitute an audit warning sign;

(iv) likewise, PwC denies that options trading utilizing the over-the-counter market somehow constituted an audit warning sign. Further, and even if this were the case, which is denied, options are not reflected on the balance sheet and PwC denies that it was required to assess the credit risk of over-the-counter options as alleged, or at all;

(v) PwC was neither required to review the trading tickets of BLMIS, nor the associated CUSIP numbers. In any event, paper trading tickets do not represent an audit warning sign;

(vi) as above, the fact that BLMIS, as a broker-dealer, could generate its own trading tickets was not a warning sign. As pleaded in subparagraph (i) above, the fact that BLMIS was a broker-dealer, and the sub-custodian, was openly disclosed in the private placement memoranda and known to all;

(vii) the fact that BLMIS did not provide electronic access (to PwC or to others) was well known to the Fairfield Principals and Fairfield Entities and was not an audit warning sign; and

(viii) the Fairfield Funds incorrectly allege that member firms of PwCI share information and services. The communications by PwC with PwC Netherlands were limited to those typical of a predecessor/successor auditor. PwC's communications with PwC Bermuda were limited to the procedures conducted by PwC Bermuda at BLMIS to obtain audit evidence relevant to the firms' respective audit engagements. There was no sharing between PwC and PwC Bermuda of any other information regarding the details of their respective audit clients or engagements. In any event, even if that were true, which is denied, other member firms did not express concerns with respect to BLMIS.

112. In the result, therefore, PwC denies that the alleged "Audit Warning Signs" were warning signs at all, or in the alternative, that such warning signs ought to have increased PwC's level of professional skepticism.

113. Further, and to the extent the alleged "Audit Warning Signs" pleaded or others, actually constitute warning signs at all, such warning signs were known to the Fairfield, Fairfield Entities Principals and the Fairfield Funds for many years prior to PwC's engagement in 2006. As pleaded herein, each of those entities was in as good a position, or better position, than PwC to identify the warning signs and to raise concern but they failed to do so. It is unfair of the Fairfield Funds to now use 20/20 hindsight to criticize PwC.

G. THE CLOSE ASSOCIATION OF THE FAIRFIELD ENTITIES AND FAIRFIELD PRINCIPALS WITH MADOFF AND BLMIS

114. Unlike the Fairfield Principals, PwC did not have on-going regular contact with the Fairfield Entities or Fairfield Funds. Similarly, PwC did not have on-going regular contact, or the opportunity for such contact, with Madoff and/or BLMIS. Rather, and in accordance with customary audit practice, PwC conducted its audits over a relatively short period of time each year. The audit of the December 31, 2006 financial statements was conducted in the Spring of 2007 and the audit of the December 31, 2007 financial statements was conducted in the Spring of 2008.

115. By contrast, the Fairfield Principals were responsible for the day-to-day business activities and operations of all of the Fairfield Entities, including the Fairfield Funds. As such, from and after 1990, when Tucker introduced Noel to Madoff, the Fairfield Principals and the Fairfield Entities were closely involved, or had the opportunity to be closely involved, with both Madoff and/or BLMIS for some 18 years through until December 11, 2008.

116. Indeed, commencing in or about 1990, the Fairfield Principals and Fairfield Entities represented to investors or potential investors, by word and conduct, that BLMIS, under

the guidance and direction of Madoff, was a highly successful and reputable firm, with billions of assets under management. Among other things, the Fairfield Principals and Fairfield Entities, or one or more of them:

(a) participated in the preparation and dissemination of the private placement and offering memoranda of various funds that invested in BLMIS, including the Fairfield Funds;

(b) published and disseminated periodic updates and performance reports, as well as other marketing and sales materials for various funds, which confirmed significant assets under management, including the Fairfield Funds;

(c) promoted, and confirmed, that assets which the Fairfield Entities invested with BLMIS existed and were being invested by BLMIS using the SSC strategy and that such assets, including assets in the Fairfield Funds, were earning substantial and consistent historical returns; and

(d) represented that the Fairfield Entities, either directly or indirectly, had conducted appropriate due diligence and risk management concerning the operations of BLMIS.

117. Through their long association, and close involvement with Madoff and BLMIS over many years, the Fairfield Principals and Fairfield Entities endorsed, promoted and purported to confirm the existence, viability and success of the funds they managed, including the Fairfield Funds, and the viability and success of Madoff and BLMIS to investors and potential investors.

118. In addition, the Fairfield Principals and Fairfield Entities represented to investors and to potential investors that they monitored and oversaw BLMIS' operations, that they independently verified transactions, confirmed the existence of assets entrusted to BLMIS and that they had transparency and access to Madoff/BLMIS.

119. Further, and specifically with respect to the Fairfield Principals, the Fairfield Funds and two of the Fairfield Entities worked especially closely with Madoff and/or BLMIS. FGL was the Placement Agent for Fairfield Sentry and FGBL was the Investment Manager for all three Fairfield Funds.

120. As Placement Agent, FGL was responsible for marketing the Fairfield Funds.

121. As Investment Manager, FGBL was responsible for providing each Fairfield Fund with on-going investment management services, which included:

(a) seeking suitable investment opportunities and managing the investment portfolios of each fund;

(b) overseeing the day-to-day investment operations of each fund;

(c) acting as the investment adviser for each fund in connection with investment decisions;

(d) providing information in connection with preparation of all reports to fund shareholders of each fund; and

(e) arranging for, and overseeing, the services of administrators, custodians, auditors and counsel of each fund.

122. The Fairfield Principals and Fairfield Entities also represented to investors and potential investors, in separate placement memoranda and elsewhere, that they had obtained underlying portfolio information for monitoring and client communication purposes. They further represented (in marketing materials) that they conducted daily monitoring of Madoff's activities and compliance with fund guidelines. They indicated that they conducted "detailed daily compliance monitoring of portfolio activity against all risk limits" and "daily positions-

based risk measurement, performance attribution and other quantitative analytics." They similarly represented that "portfolio holdings are reconciled daily" using proprietary software and that "the Investment Manager monitors compliance of the SSC strategy against these risk limits and guidelines each day."

123. The Fairfield Principals and Fairfield Entities also represented to investors and potential investors that they conducted regular on-site visits of Madoff and that they conducted in-depth, multi-faceted due diligence and risk monitoring of the funds, including the Fairfield Funds. They also represented that they conducted an "[a]nalysis of portfolio composition, portfolio stress testing, risk management, asset verification, peer group comparison, operational procedures, information technology, and a review of offering documents and financial statements."

124. In addition, the Fairfield Principals and Fairfield Entities consistently promoted the fundamental importance of transparency into Madoff's operations as fund manager. For instance, they acknowledged that "[o]nly by receiving full transparency from its managers can FGG assure itself and its clients that every FGG fund continues to act according to the principles, agreements, and strategies that are specified to FGG and investors."

125. The Fairfield Principals and Fairfield Entities specifically represented to investors or potential investors that they required full transparency from all of their fund managers, including Madoff. And specifically with respect to BLMIS, they stated that they "maintain full transparency" and perform "[i]ndependent verification of prices and account values." They similarly represented that, "[f]or risk monitoring purposes, FGG obtains portfolio transparency from all managers which are included in its multi-strategy funds." They even claimed that the

FGG business model enables the firm "to have privileged access to all aspects of a manager's operation and investment process, including security level transparency which is employed on a confidential basis."

126. Further, the private placement memorandum for each of the Fairfield Funds included a "Uniform Application for Investment Adviser Registration" prepared by FGBL for registration as an investment adviser. Within that application, and dealing with the review of accounts in particular, FGBL represented as follows:

> Accounts [of the Fairfield Funds] are reviewed by the individual security level in Bermuda and discussed among members of the Applicants [FGBL] team several times each month. Applicants [FGBL] also utilizes a number of independent, sophisticated quantitative membership tools to monitor the performance of its accounts...compliance with investment guidelines, and risk analysis. Applicants [FGBL] personnel review changes in a variety of factors, including changes in organization, investment process, the manager's view of the relevant markets, and their portfolio's position with respect to those views. The findings are discussed at regular investment committee meetings.

127. The Fairfield Principals and Fairfield Entities were obligated to share information amongst themselves concerning Madoff/BLMIS on a timely basis and to properly manage the Fairfield Funds in accordance with their agreements, representations, marketing materials, internal guidelines and industry practice. In the course of their audit engagements, and in response to inquiries regarding these matters, PwC became aware of the representations made by the Fairfield Principals, Fairfield Entities and Fairfield Funds pleaded above and those same representations, or representations to substantially the same effect, were made to PwC and relied upon by it.

128. The Fairfield Principals and Fairfield Entities knew, or ought to have known, that PwC was relying on them to carry out their contractual obligations, to share information concerning Madoff/BLMIS on a timely basis and to properly manage the Fairfield Funds in accordance with their agreements, representations, marketing materials, internal guidelines and industry practice.

129. The Fairfield Principals, the Fairfield Entities, and Fairfield Funds, or one or more of them, failed to share information concerning Madoff/BLMIS on a timely basis, if at all, and failed to conduct appropriate due diligence, monitoring and oversight of Madoff/BLMIS. They also failed to manage assets entrusted with Madoff/BLMIS in accordance with the agreements, representations, marketing materials, internal guidelines and generally accepted industry practices of an investment manager.

130. Further, the representations pleaded in paragraphs 116, 117, 118, 122, 123, 124, 125, 126 and 127 above were misrepresentations to PwC. Contrary to their risk management, marketing materials and internal guidelines, the Fairfield Principals and Fairfield Entities did not conduct the represented due diligence or risk management of the funds, including the Fairfield Funds. As such, they failed to verify that assets were being properly invested, or even that the assets entrusted to Madoff/BLMIS existed. Contrary to the representations, the Fairfield Principals and Fairfield Entities also had little, if any, transparency or access to the operations of Madoff/BLMIS.

131. Further, and even though the Fairfield Principals, Fairfield Entities and Fairfield Funds knew that PwC was relying upon the aforementioned representations, at no time did they take steps to correct the representations or to inform PwC they were erroneous. PwC therefore

was incorrectly led to believe that the Fairfield Principals and Fairfield Entities were conducting thorough, and on-going due diligence and risk management of the funds, including the Fairfield Funds, when such was not the case.

H. SPECIFIC REPRESENTATIONS IN CONNECTION WITH THE PWC AUDITS

132. In January 2007, in conjunction with its client acceptance procedures for the 2006 audit, PwC met with representatives of FGG to gain an understanding of FGG's business and its services. At that time, FGG held itself out to PwC as a successful organization with considerable expertise in the hedge fund industry with, amongst other things, excellent controls, policies and procedures in its finance group. PwC reasonably relied upon these representations in accepting the audit engagements in both 2006 and 2007.

133. In addition, FGG and the Fairfield Funds, by the express terms of the Engagement Letters, or in the alternative the implied terms thereof, confirmed to PwC the viability of the Fairfield Funds, including the existence of assets entrusted to BLMIS, and the legitimacy of the Fairfield Funds' business with Madoff/BLMIS.

134. Further, and as more particularly pleaded below, FGG agreed, at the commencement of both the 2006 and 2007 audit years to provide PwC with written representation letters covering the audited financial statements, upon which FGG and the Fairfield Funds intended PwC to rely in accepting the audit engagements and forming its opinions on the financial statements of the Fairfield Funds.

135. FGG and the Fairfield Funds (and FGBL in 2006) also made specific representations to PwC in connection with the respective audits of the 2006 and 2007 financial

statements (the "**Financial Statements**"). The representations were made by way of written representation letters dated April 24, 2007 (in respect of the 2006 audit) and April 4, 2008 (in respect of the 2007 audit). The representation letters are hereinafter collectively referred to as the "**Representation Letters**".

136. The Representation Letters set out some of the responsibilities of FGG, (FGBL in 2006) and the Fairfield Funds with respect to the Financial Statements. In particular, FGG, (FGBL in 2006) and the Fairfield Entities confirmed and represented that:

(a) they were responsible for the preparation of the 2006 and 2007 Financial Statements and for the fair presentation of all information contained therein, in conformity with International Financial Reporting Standards;

(b) they had made available to PwC all financial records and related data;

(c) there were no material transactions, agreements or accounts that had not been properly recorded in the accounting records underlying the Financial Statements;

(d) they were not aware of any deficiencies in the design or operation of internal controls over financial reporting;

(e) they acknowledged their responsibility for the design and implementation of programs and controls to provide reasonable assurance that fraud was prevented and detected and that the results of their assessment were disclosed to PwC;

(f) they had no knowledge of any fraud or suspected fraud affecting the Fairfield Funds involving management, employees or others where the fraud could have a material effect on the Financial Statements;

(g) they had no knowledge of any allegations of fraud or suspected fraud affecting the Fairfield Funds; and

(h) all cash and bank accounts on all other assets of the Fairfield Funds were included in the Financial Statements at the balance sheet date.

137. In fact, the representations pleaded in paragraphs 132, 133, 134, 135 and 136 above (in addition to those summarized in paragraph 130 above) were misrepresentations. In reality, and based on the U.S. regulatory and other investigations, it is now apparent that Madoff had not made any securities transactions in the 20 years prior to his arrest and that the historical results of BLMIS reported by various of the Fairfield Entities, including the Fairfield Funds, were entirely fictitious. Rather than a reputable and highly successful firm with billions of assets under management, the reality is that BLMIS was a sham.

138. In the result, therefore, PwC accepted audit engagements for both the 2006 and 2007 audits having been induced by the representations pleaded above to believe that the Fairfield Principals and Fairfield Entities had, amongst other things, conducted appropriate and on-going due diligence and monitoring of Madoff/BLMIS over an extended period of time and that BLMIS was a reputable custodian of longstanding, with a proven track-record and billions of assets under administration. The Fairfield Principals and Fairfield Entities made the representations knowing PwC would rely, and that PwC did rely, thereon when accepting the audit engagements, scoping the audits (and preparing the audit plans) and issuing the 2006 and 2007 audit opinions.

139. Given the proximate relationship of the parties, and the Engagement Letters and Representation Letters, among other things, the Fairfield Principals, Fairfield Entities and Fairfield Funds had a duty to ensure that all of their representations were accurate and complete (including representations as to the nature, extent and knowledge of their dealings with

Madoff/BLMIS) so that PwC, in turn, could reflect and properly assess the audit risk. PwC pleads that the Fairfield Principals and Fairfield Entities are liable for misrepresentation for having made the misrepresentations pleaded above and for failing to correct the misrepresentations. PwC would not have accepted either the 2006 or 2007 audit engagement, or entered into the Engagement Letters, had such disclosure been made. In the alternative, had such disclosures been made after PwC accepted either engagement, it would have resigned its engagement (as it did when asked to audit the funds financial statements as of December 31, 2008 after the fraud was revealed) or, at a minimum, declined to issue its audit opinions.

140. In all of the circumstances, and in any event, and in light of the misrepresentations pleaded above and PwC's reasonable reliance thereon, PwC pleads that the Fairfield Funds are estopped from advancing the claims asserted in the statement of claim against PwC.

I. NEGLIGENCE OF THE FAIRFIELD PRINCIPALS, FAIRFIELD ENTITIES AND FAIRFIELD FUNDS

141. Among other things, FGL and FGBL failed to carry out their responsibilities under their respective agreements, namely, the Placement Agent and Investment Manager agreements, and to otherwise manage the Fairfield Funds in accordance with their representations, internal guidelines, marketing materials and common law duties, as placement agents and investment managers. FGL and FGBL, and the Fairfield Principals associated therewith, also failed to manage the Fairfield Funds in accordance with industry practice. The negligence of FGL and FGBL, as partners and agents, will be attributed to the Fairfield Funds and is conduct for which the Fairfield Funds are responsible.

142. More generally, and as pleaded above, the Fairfield Principals and Fairfield Entities, as partners and agents, breached their duties to one another and were negligent for at least the following reasons:

(a) the Fairfield Principals and Fairfield Entities had not, in fact, conducted thorough due diligence of, or exercised oversight over, Madoff and his operations and they had not determined that Madoff actually invested assets utilizing the SSC strategy, with a long track record of achieving positive investment returns;

(b) the Fairfield Entities, including the Fairfield Funds, had not invested assets in legitimate funds that utilized the SSC strategy;

(c) the Fairfield Entities had not monitored the investments in the Fairfield Funds to confirm that the funds were operated legitimately using the SSC strategy and had not verified transactions, including that Madoff actually made the represented trades and that the Fairfield Funds actually held the represented assets;

(d) the due diligence and oversight process employed by the Fairfield Entities did not provide transparency into all aspects of Madoff's operations, and thus did not allow the Fairfield Entities, including the Fairfield Funds, to confirm that the assets provided to Madoff were actually and legitimately invested; and

(e) the purported net asset values of the investments in the Fairfield Funds were fictitious.

143. Additionally, the Fairfield Principals and Fairfield Entities overlooked, or failed to investigate, or adequately investigate, questions and/or concerns regarding Madoff's operations raised by others, including employees, investors, Citco and the SEC.

144. By example, when investors raised questions about Madoff, the Fairfield Principals and Fairfield Entities gave "pro-forma" answers to assuage concerns based on a set of

standardized answers designed to confirm the veracity and legitimacy of Madoff's operations. Additionally, the Fairfield Principals and Fairfield Entities were not forthright and misrepresented the size and specialization of Madoff's auditor, F&H, in response to inquiries. Further, when the SEC investigated Madoff in or about 2005, the Fairfield Principals and Fairfield Entities did not use the opportunity to provide meaningful assistance, but rather, worked with Madoff (and sought and followed his instructions) on how to approach their testimony.

145. In the result, therefore, the Fairfield Principals and Fairfield Entities were negligent in not only failing to conduct appropriate due diligence and risk management of the funds, including in the Fairfield Funds, but also, in failing to appropriately address questions and/or concerns with respect to Madoff and BLMIS raised by third parties from time to time. PwC seeks disclosure of the questions and/or concerns raised by third parties and the manner in which those questions and/or concerns were handled by the Fairfield Principals and Fairfield Entities.

146. Insofar as the negligence of the Fairfield Principals and Fairfield Entities is concerned, PwC pleads that such negligence must be attributed to the Fairfield Funds and that the damages, if any, recoverable by the Fairfield Funds must be entirely eliminated or substantially reduced by the contributory negligence of all of the Fairfield Principals and Fairfield Entities and Fairfield Funds.

J. FEES EARNED BY THE FAIRFIELD PRINCIPALS AND FAIRFIELD ENTITIES

147. The Fairfield Principals and Fairfield Entities profited handsomely from their efforts to promote, and thereafter, ostensibly manage funds invested in BLMIS, including the Fairfield Funds. The fees, well into the hundreds of millions of dollars, included placement fees, performance fees, management fees, incentive/performance fees and administrative fees (collectively the "**Fairfield Fees**"). PwC does not have particulars of the Fairfield Fees which the Fairfield Principals and Fairfield Entities paid themselves and PwC seeks production and an accounting of all such fees which were generated, and paid, based on non-existent profits and asset values.

148. PwC pleads that the Fairfield Principals and Fairfield Entities were not entitled to be paid or to recover any of the Fairfield Fees.

K. NO DAMAGES

149. PwC denies that the Fairfield Funds have suffered the damage alleged in the statement of claim or any damage at all and puts the Fairfield Funds to the strict proof thereof. If the Fairfield Funds have suffered damage, which is denied, such damage was not caused by any act or omission of PwC. In any event, the Fairfield Funds claim for damages is excessive, unforeseeable, remote and arise from causes for which PwC is not responsible. Further, the Fairfield Funds have failed to mitigate their damage.

150. PwC pleads in the alternative that the damage suffered by the Fairfield Funds, if any, was caused, or contributed to, by their own negligence or the negligence of other Fairfield Principals or Fairfield Entities for which they are responsible in law. If the Fairfield Principals

and/or Fairfield Entities had not been negligent with respect to their own due diligence, risk management and monitoring of BLMIS, and in particular, the continued existence of the assets which the Fairfield Funds entrusted to BLMIS, they would have discovered the fraud well before PwC was engaged to conduct the 2006 audit. The Fairfield Entities, therefore, and the Fairfield Funds themselves, are entirely responsible for the loss, if any, they suffered by reason of the Madoff fraud.

151. In the further alternative, if PwC was negligent, which is denied, the claim for damages asserted herein should be reduced by reason of the plaintiffs' own negligence. PwC pleads and relies upon the provisions of the *Negligence Act*, R.S.O. 1990, c.N. 1.

152. The claims asserted herein are in fact an attempt to recover investor losses for which PwC is not liable. Further, any damage claims in contract (i.e. pursuant to the Engagement Letters) must be limited, as a matter of law, to those damages which were in the reasonable contemplation of the parties at the time of the engagements and the claims asserted herein were not so contemplated.

153. Any damage claim in tort is also subject to policy considerations which limit recoverable damage, if any, based on the principles enunciated by the Supreme Court of Canada in *Hercules Managements Ltd. v. Ernst & Young*, [1997] 2 S.C.R. 165. PwC pleads that such principles, properly applied, preclude the Fairfield Funds from recovering against PwC any loss suffered by persons who invested in the Fairfield Funds.

154. Among other things, the Fairfield Funds failed to take appropriate steps, in a timely fashion, to identify, preserve, and recover assets. The Fairfield Funds thereby failed to mitigate their alleged damage by, amongst other things, failing to take steps:

(a) to recover the Fairfield Fees from the Fairfield Principals, Fairfield Entities, and others;

(b) to recover general damages from the Fairfield Principals, Fairfield Entities and other Fairfield partners, including FGL and FGBL, for breach of contract, negligence, negligent misrepresentation and breach of fiduciary duty; and

(c) to recover damages for the failure of other persons and entities to fulfil their obligations to the Fairfield Entities, including the Fairfield Funds.

155. PwC does not know the steps the liquidator has taken, or failed to take, and seeks production of all documents in the liquidator's possession, power or control to permit PwC to assess the reasonableness of the liquidator's actions.

156. PwC complied with all prevailing generally accepted audit standards in 2006 and 2007 when conducting its audit work. But, even if it failed to do so, which is denied, any such failure did not cause the alleged loss claimed by the Fairfield Funds for the following reasons, among others:

(a) first, the Fairfield Funds obtained the money they now seek to recover from PwC by reason of their own misrepresentations. Investors would not have invested in the Fairfield Funds but for such misrepresentations and the Fairfield Funds therefore are the cause, and solely responsible, for their own damage;

(b) second, and by reason of the sophisticated and collusive fraud, any additional auditing steps and/or enquiries made by PwC would have been satisfactorily answered (albeit fraudulently) by Madoff and his co-conspirators;

(c) third, no audit opinion given by PwC caused the Fairfield Funds to suffer the damage claimed in the statement of claim. The Fairfield Funds had already invested more than $6 billion in BLMIS before PwC first audited the Fairfield Funds in 2006; and

(d) fourth, the funds invested by the Fairfield funds on a net basis after the issuance of PwC's first audit opinion constitute a negative number meaning that the redemptions exceeded new assets invested.

157. Further, by failing to detect the fraud in a timely manner and by continuing to actively promote and market Madoff and/or BLMIS to potential investors, the Fairfield Principals and Fairfield Entities exacerbated the damage, if any, suffered by the Fairfield Funds by reason of the steps they continued to take to attract additional funds into the Ponzi scheme. The action or inaction of the Fairfield Principals and Fairfield Entities (in failing to detect the fraud and in continuing to market Madoff and/or BLMIS) is conduct attributable to the Fairfield Funds for which the Fairfield Funds are responsible.

158. PwC denies that there are circumstances under which it might be liable to the Fairfield Funds for damages. However, if PwC is liable to the Fairfield Funds for some amount of damage, which is denied, then PwC is entitled to set off such damage against any damage the Fairfield Funds are found liable to PwC pursuant to the counterclaim below.

159. PwC therefore requests that this action be dismissed with costs on a substantial indemnity, or in the alternative, partial indemnity scale.

COUNTERCLAIM

160. PwC claims against the plaintiffs/defendants to the counterclaim the Fairfield Funds:

(a) damages in an amount to be determined for breach of the Engagement Letters;

(b) in addition, or in the alternative, damages for misrepresentation in an amount to be determined;

(c) pre-judgment and post-judgment interest pursuant to the *Courts of Justice Act*, R.S.O. 1990, c. C. 43, as amended; and

(d) its costs of this counterclaim on a substantial indemnity, or in the alternative, partial indemnity, basis.

161. PwC repeats and relies upon the allegations contained in the statement of defence.

162. By the express terms of the Engagement Letters, or in the alternative the implied terms thereof, FGG for and on behalf of the Fairfield Funds, confirmed to PwC the viability of the Fairfield Funds, including the existence of assets entrusted to BLMIS and the legitimacy of the Fairfield Funds' business with Madoff/BLMIS.

163. FGG, for and behalf of the Fairfield Funds, also confirmed that the Fairfield Funds had established and maintained an effective system of internal controls and had policies and procedures in place to maintain accounting records, safeguard assets, properly record transactions (in the accounting records) and properly report financial information in conformity with International Financial Reporting Standards.

164. The Fairfield Funds also agreed to adjust their financial statements (in 2006 and 2007) to correct material misstatements and that the effects of any uncorrected misstatements pertaining to the year under audit (in 2006 or 2007) were immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

165. The Fairfield Funds also agreed, as a term of the Engagement Letters, to provide PwC with accurate representations covering the 2006 and 2007 financial statements upon which PwC (to the knowledge of the Fairfield Funds) would rely in forming PwC's audit opinions of the financial statements of the Fairfield Funds in both 2006 and 2007.

166. By reason of the facts pleaded above and in the statement of defence, PwC pleads that the Fairfield Funds, either alone or in concert with FGG, breached the terms of the Engagement Letters for which they are liable.

167. In addition, the Engagement Letters include the following clause:

> "The Client hereby agrees to release and indemnify PricewaterhouseCoopers and its agents, partners and employees, and hold them harmless from all claims, liabilities, losses and costs arising in circumstances where there has been such a misrepresentation by a member of the Client's management or board of directors, regardless of whether such person was acting in the Client's interest. This release and indemnification and holding harmless will not operate where PricewaterhouseCoopers ought to have uncovered such misrepresentation but failed to, due to the negligence, wilful misconduct or dishonesty of PricewaterhouseCoopers, its partners and/or employees"

168. Further, by reason of the misrepresentations and other facts pleaded above and in the statement of defence, the Fairfield Funds breached the terms of the Engagement Letters, and thus, cannot proceed with the claims advanced in this action. The Fairfield Funds must therefore indemnify PwC for all damages caused by the breach of contract and/or misrepresentations of

FGG and the Fairfield Funds, or the misrepresentations of the Fairfield Principals and Fairfield Entities, for which they are liable.

169. In any event, given the relationship between the parties, the Fairfield Funds owed PwC a duty of care, which duty of care was breached. The misrepresentations made by the Fairfield Funds were reasonably relied upon by PwC and PwC has suffered damages for which the Fairfield Funds are liable.

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Proceeding commenced at
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