

**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

Defendant

STATEMENT OF CLAIM

TO THE DEFENDANT

A LEGAL PROCEEDING HAS BEEN COMMENCED AGAINST YOU by the plaintiffs. The claim made against you is set out in the following pages.

IF YOU WISH TO DEFEND THIS PROCEEDING, you or an Ontario lawyer acting for you must prepare a statement of defence in Form 18A prescribed by the Rules of Civil Procedure, serve it on the plaintiffs' lawyer or, where the plaintiffs do not have a lawyer, serve it on the plaintiffs, and file it, with proof of service, in this court office, WITHIN TWENTY DAYS after this statement of claim is served on you, if you are served in Ontario.

If you are served in another province or territory of Canada or in the United States of America, the period for serving and filing your statement of defence is forty days. If you are served outside Canada and the United States of America, the period is sixty days.

Instead of serving and filing a statement of defence, you may serve and file a notice of intent to defend in Form 18B prescribed by the Rules of Civil Procedure. This will entitle you to ten more days within which to serve and file your statement of defence.

IF YOU FAIL TO DEFEND THIS PROCEEDING, JUDGMENT MAY BE GIVEN AGAINST YOU IN YOUR ABSENCE AND WITHOUT FURTHER NOTICE TO YOU. IF YOU WISH TO DEFEND THIS PROCEEDING BUT ARE UNABLE TO PAY LEGAL FEES, LEGAL AID MAY BE AVAILABLE TO YOU BY CONTACTING A LOCAL LEGAL AID OFFICE.

IF YOU PAY THE PLAINTIFFS' CLAIM, and \$2,000.00 for costs, within the time for serving and filing your statement of defence, you may move to have this proceeding dismissed by the court. If you believe the amount claimed for costs is excessive, you may pay the plaintiffs' claim and \$400.00 for costs and have the costs assessed by the court.

Date May 28, 2012

Issued by 
Local registrar

Address of court office 393 University Avenue Toronto, ON
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TO: PRICEWATERHOUSECOOPERS LLP
Royal Trust Tower, Suite 3000
Toronto-Dominion Centre
77 King Street West
Toronto, Ontario M5K 1G8
Canada

AND TO: STEPHEN WALL
Royal Trust Tower, Suite 3000
Toronto-Dominion Centre
77 King Street West
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Canada

CLAIM

1. The Plaintiffs claim:
 - (a) A declaration that the Defendant PricewaterhouseCoopers LLP (“PWC”) was in breach of contract and/or negligent in its performance of the audit of the Plaintiffs’ financial statements with respect to the year ending December 31, 2006 (“Fiscal 2006”);
 - (b) A declaration that the Defendant Stephen Wall (“Wall”) was negligent in his performance of the audit of the Plaintiffs’ financial statements with respect to Fiscal 2006;
 - (c) A declaration that PWC was in breach of contract and/or negligent in its performance of the audit of the Plaintiffs’ financial statements with respect to the year ending December 31, 2007 (“Fiscal 2007”);
 - (d) A declaration that Wall was negligent in his performance of the audit of the Plaintiffs’ financial statements with respect to Fiscal 2007;
 - (e) A declaration that, for each of Fiscal 2006 and Fiscal 2007, PWC negligently misrepresented that the Plaintiffs’ financial statements were:
 - (i) audited in accordance with applicable Generally Accepted Auditing Standards (“GAAS”); and/or
 - (ii) fairly presented in accordance with Generally Accepted Accounting Principles (“GAAP”);
 - (f) \$5,000,000,000 in damages for breach of contract, negligence and/or negligent misrepresentation;
 - (g) pre-judgment and post-judgment interest pursuant to sections 128 and 129 of the *Courts of Justice Act*, R.S.O. 1990, c. C.43;
 - (h) Costs on a substantial indemnity basis; and
 - (i) Such further and other relief as this Court deems just.

Overview

2. Fairfield Sentry Limited (“Sentry”) is a fund that invested over 95% of its funds with Bernard L. Madoff Investments Securities LLC (“BLM”).
3. Fairfield Sigma Limited (“Sigma”) is a fund that invested all of its funds in Sentry.
4. Fairfield Lambda Limited (“Lambda”) is a fund that invested all of its funds in Sentry.
5. On or about December 11, 2008, it was discovered that Bernard L. Madoff (“Madoff”) and BLM had, at all times, been engaged in a fraudulent enterprise characterized colloquially as a “Ponzi scheme”. Madoff was arrested, pled guilty to criminal fraud charges and was sentenced to 150 years in prison. BLM ceased to operate on December 11, 2008 and began liquidating.
6. Madoff has admitted, and subsequent court-supervised investigations have confirmed, that BLM:
 - (a) had not traded or purchased any securities on the account of any customer since, at least, 1995; and
 - (b) falsified trading confirmations and client account statements for clients, including the Plaintiffs, purportedly involved in the “split strike conversion” strategy (“SSC Strategy”) to give the appearance that bogus transactions and positions had occurred.
7. The Plaintiffs relied on PWC to opine on the fairness of the financial statements of Sigma, Lambda and Sentry and, in so doing, to provide reasonable assurance that the financial statements were free of material misstatements.
8. The Plaintiffs relied on Wall, as the engagement partner, to organize and supervise the review and audit teams at PWC in their conduct of the engagements, which led to PWC’s opinion on the fairness of the Plaintiffs’ financial statements and its provision of reasonable assurance that the financial statements were free of material misstatements.
9. BLM represented to PWC that: (a) it acted not only as broker and sub-custodian of the bulk of the Plaintiffs’ assets, but also made all decisions as investment manager in implementing

the SSC Strategy; (b) even though 99% of the trades made to implement the SSC Strategy were done electronically by BLM's cutting-edge technology, the Plaintiffs were not allowed to view their accounts remotely over the internet and were limited to receiving paper trade confirmations and monthly account statements by mail; and (c) Madoff himself maintained tight control over the operations while most of the remaining, key positions were filled by his brother, two sons, cousin and niece. In light of this knowledge, the Defendants were obliged to plan the audits taking into account the enhanced risk of fraud at BLM and to perform sufficient testing and verification procedures on BLM so as to confirm the existence and value of the Plaintiffs' assets with BLM.

10. The Defendants breached the duties of care owed to Sigma, Lambda and Sentry by failing to perform the audits in accordance with applicable GAAS and by stating in the audit reports, falsely and without basis, that the financial statements of Sigma, Lambda and Sentry fairly presented, in all material respects, the financial position of such funds in accordance with International Financial Reporting Standards ("IFRS"). More particularly, the Defendants failed to properly confirm the existence and value of the Plaintiffs' assets at BLM through the application of GAAS and GAAP and the proper performance of the duties of care owed to the Plaintiffs in law.

11. References to GAAP herein include, where applicable, Canadian GAAP, U.S. GAAP and IFRS. References to GAAS herein include, where applicable, Canadian GAAS, U.S. GAAS and International Standards on Auditing ("ISA").

12. The Plaintiffs suffered damages by, in reliance on the work and supervision of Wall and on the clean audit opinions issued by PWC, incurring additional liabilities and continuing to deal with BLM after PWC ought to have alerted Sentry to the true state of the accounts it held with BLM.

The Key Players

13. Sentry was incorporated as an International Business Company under the *International Business Companies Act* of the British Virgin Islands on October 30, 1990. Sentry was automatically re-registered on January 1, 2007 as a business company under the *BVI Business*

Companies Act, 2004. Sentry's registered office is located in Romasco Place, Wickhams Cay 1, Road Town, Tortola, British Virgin Islands, VG1110.

14. Sigma was incorporated as an International Business Company under the *International Business Companies Act* of the British Virgin Islands on November 20, 1990. Sigma was automatically re-registered on January 1, 2007 as a business company under the *BVI Business Companies Act, 2004*. Sigma's registered office is located in Romasco Place, Wickhams Cay 1, Road Town, Tortola, British Virgin Islands, VG1110.

15. Lambda was incorporated as an International Business Company under the *International Business Companies Act* of the British Virgin Islands on December 7, 1990. Lambda was automatically re-registered on January 1, 2007 as a business company under the *BVI Business Companies Act, 2004*. Lambda's registered office is located in Romasco Place, Wickhams Cay 1, Road Town, Tortola, British Virgin Islands, VG1110.

16. On April 23, 2009, the Eastern Caribbean Supreme Court in the High Court of Justice of the British Virgin Islands (the "BVI Court") ordered that Lambda be liquidated and appointed Christopher Stride as its liquidator. On July 21, 2009 the BVI Court ordered that Sentry and Sigma be liquidated and appointed Kenneth Krys and Christopher Stride as its liquidators.

17. Effective September 8, 2010, Mr. Stride resigned as liquidator of Lambda, Sentry and Sigma. Ms. Joanna Lau was appointed as liquidator of Sentry and Sigma, and Mr. Krys and Ms. Lau were appointed as liquidators of Lambda. These appointments were made in accordance with resolutions passed at meetings of the creditors of Lambda, Sentry and Sigma on September 6, 2010.

18. Effective November 24, 2011, Ms. Lau resigned as liquidator of Lambda, Sentry and Sigma. Mr. Krys is currently the sole liquidator of Lambda, Sentry and Sigma.

19. PWC is a limited liability partnership organized under the laws of the Province of Ontario in Canada, carrying on business as a firm of accountants and auditors with its principal place of business in Toronto, Ontario.

20. PWC served as auditor of Sentry, Lambda and Sigma for Fiscal 2006 and Fiscal 2007 and conducted review engagements in respect of the Plaintiffs' financial statements for the six month periods ending June 30, 2007 and June 30, 2008.

21. Wall is a resident of Ontario, who served as the engagement partner at PWC in respect of its audits and reviews of the Plaintiffs.

22. PricewaterhouseCoopers Accountants N.V. ("PWCNL") carries on business as a firm of accountants and auditors with its principal place of business in Rotterdam, The Netherlands. PWCNL served as auditor for Sentry, Lambda and Sigma for the fiscal year ended December 31, 2005 ("Fiscal 2005") and for several prior fiscal years.

23. PWC and PWCNL are both member firms of PricewaterhouseCoopers International Limited ("PWCI"). PWCI, and all of its member firms, provide auditing and accounting services globally. All member firms of PWCI represent that they: (a) uphold the highest standards of care as auditors and accountants throughout the world; and (b) provide global service seamlessly as a cohesive business entity. PWCI sets standards for its member firms to follow in addition to the robust standards that each member sets out in its own manuals.

Background

24. Sigma and Lambda invested all of their funds in Sentry.

25. Sentry invested substantially all of its assets with BLM.

26. BLM acted as the broker for Sentry, Lambda and Sigma.

27. BLM also acted as sub-custodian of the assets of Sentry, Lambda and Sigma.

28. BLM also acted as the investment manager for Sentry, Lambda and Sigma.

29. The investment policy of Lambda, as set out in its October 1, 2004 private placement memorandum (the "Lambda PPM"), was as follows:

The Fund seeks to obtain capital appreciation of its assets primarily investing in Fairfield Sentry, a British Virgin Islands Corporation ("FSL"). FSL principally utilizes a non-traditional options trading strategy described as "split strike conversion", to which the Fund

allocates the predominant portion of its assets. This strategy has defined risk and profit parameters, which may be ascertained when a particular position is established. Set forth below is a description of the "split strike conversion" strategies ("SCC Investments").

The establishment of a typical position entails (i) the purchase of a group or basket of equity securities that are intended to highly correlate to the S&P 100 Index, (ii) the sale of out-of-pocket money S&P 100 Index call options in an equivalent contract value dollar amount to the basket of equity securities, and (iii) the purchase of an equivalent number of out-of-the-money S&P 100 Index put options. An index call option is out-of-the-money when its strike price is greater than the current price of the index; an index put option is out-of-the-money when the strike price is lower than the current price of the index. The basket typically consists of approximately 35 to 45 stocks in the S&P 100.

The logic of this strategy is that once a long stock position has been established, selling a call against such long position will increase the standstill rate of return, while allowing upward movement to the short call strike price. The purchase of an out-of-the-money put, funded with part or all of the call premium, protects the equity position from downside risk.

A bullish or bearish bias of the positions can be achieved by adjustment of the strike prices in the S&P 100 puts and calls. The further away the strike prices are from the price of the S&P 100, the more bullish the strategy. However, the dollar value underlying the put options always approximates the value of the basket of stocks.

The options transactions executed for the benefit of the Fund may be effected in the over-the-counter market or on a registered options exchange.

30. The investment policy of Sigma, as set out in its February 16, 2006 private placement memorandum (the "Sigma PPM"), was as follows:

The Fund seeks to obtain capital appreciation of its assets by primarily investing in Fairfield Sentry Limited, a British Virgin Islands corporation ("FSL"). FSL principally utilizes a nontraditional options trading strategy described as "split strike conversion". This strategy has defined risk and profit parameters which may be ascertained when a particular position is established. Set forth below is a description of the "split strike conversion" strategy.

The establishment of a typical position entails (i) the purchase of a group or basket of equity securities that are intended to highly correlate to the S&P 100 Index, (ii) the sale of out of the money S&P 100 Index call options in an equivalent contract value dollar amount to the basket of equity securities, and (iii) the purchase of an equivalent number of out of the money S&P 100 Index put options. An index call option is out of the money when its strike price is greater than the current price of the stock;

an index put option is out of the money when the strike price is lower than the current price of the index. The basket typically consists of approximately 35 to 40 stocks in the S&P 100.

The logic of this strategy is that once a long stock position has been established, selling a call against such long position will increase the standstill rate of return, while allowing upward movement to the short call strike price. The purchase of an out of the money put, funded with part or all of the call premium, protects the equity position from downside risk.

A bullish or bearish bias of the positions can be achieved by adjustment of the strike prices in the S&P 100 Index puts and calls. The further away the strike prices are from the price of the S&P 100 Index, the more bullish the strategy. However, the dollar value underlying the put options always approximates the value of the basket of stocks.

The options transactions executed for the benefit of FSL, and indirectly, the Fund, may be effected in the over-the-counter market or on a registered options exchange. (See "POTENTIAL CONFLICTS OF INTEREST").

The Split Strike Conversion strategy is implemented by Bernard L. Madoff Investment Securities ("BLM") through accounts maintained at that firm. The accounts are subject to certain guidelines which, among other things, impose limitations on the minimum number of stocks in the basket, the minimum market capitalization of the equities in the basket, the capitalization weightings of each security in the basket, the minimum correlation of the basket against the S&P100 Index, and the permissible range of option strike prices. **Subject to the foregoing guidelines, BLM is authorized to determine the price and timing of stock and option transactions in the account. The services of BLM and its personnel are essential to the continued operation of the Fund, and its profitability, if any.** [Emphasis Added]

31. The investment policy of Sentry, as set out in its August 14, 2006 private placement memorandum (the "Sentry PPM"), was as follows:

The Fund seeks to obtain capital appreciation of its assets principally through the utilization of a non-traditional operations trading strategy described as "split strike conversion", to which the Fund allocates the predominant portion of its assets. Set forth below is a description of the "split strike conversion" strategies ("SSC Investments").

The establishment of a typical position entails (i) the purchase of a group or basket of equity securities that are intended to highly correlate to the S&P 100 Index, (ii) the purchase of out-of-the-money S&P 100 Index put options with a notional value that approximately equals the market value of the basket of equity securities, and (iii) the sale of out-of-the-money S&P Index call options with a notional value that approximately equals the market value of the basket of equity securities. An index call

option is out-of-the-money when its strike price is greater than the current price of the index; an index put option is out-of-the-money when the strike price is lower than the current price of the index. The basket typically consists of between 35 to 50 stocks in the S&P 100 Index.

The primary purpose of the long put options is to limit the market risk of the stock basket at the strike price of the long puts. The primary purpose of the short call options is to largely finance the cost of the put hedge and to increase the stand-still rate of return.

This position in its entirety could be characterized as a bull spread which, presuming the stock basket highly correlates to the S&P 100 Index, is intended to work as follows: (i) it sets a floor value below which the declines in the value of the stock basket is offset by gains in the put options; (ii) it sets a ceiling value beyond which further gains in the stock basket are offset by increasing liability of the short calls, and (iii) defines a range of potential market gain or loss, depending on how tightly the options collar is struck.

The degree of bullishness of the strategy can be expressed at implementation by the selection of the strike prices in the S&P 100 Index put and call options. The farther away the strike prices are from the price of the S&P Index, the more bullish the strategy.

The Split Strike Conversion strategy is implemented by Bernard L. Madoff Investments Securities LLC (“BLM”), a broker-dealer registered with the Securities and Exchange Commission, through accounts maintained by the Fund at that firm. The accounts are subject to certain guidelines which, among other things, impose limitations on the minimum number of stocks in the basket, the minimum market capitalization of the equities in the basket, the minimum correlation of the basket against the S&P 100 Index, and the permissible range of option strike prices. **Subject to the guidelines, BLM is authorized to determine the price and timing of stock and option transactions in the account. The services of BLM and its personnel are essential to the continued operation of the Fund, and its profitability, if any.**

The options transactions executed for the benefit of the Fund may be effected in the over-the-counter market or on a registered options exchange. [Emphasis Added]

32. For several fiscal years up to, and including, Fiscal 2005, PWCNL was engaged to audit each of Sigma, Lambda and Sentry. PWCNL undertook to audit the financial statements of Sigma, Lambda and Sentry in accordance with GAAS as set out in ISA, applying GAAP in accordance with IFRS.

33. PWCNL issued clean audit reports for Sigma, Lambda and Sentry for each of the years it served as auditor. For example, PWCNL issued a clean audit opinion dated May 23, 2000 with

respect to the financial statements of Sentry for the fiscal year ended December 31, 1999. The opinion stated as follows:

“Introduction

We have audited the accompanying balance sheet of Fairfield Sentry Limited, Road Town, Tortola, for the year ended December 31, 1999 and the related statements of operations and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

Scope

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion the financial statements give a true and fair view of the financial position of the Company as at December 31, 1999 and of the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.”

34. PWCNL represented to the Plaintiffs that it had satisfied itself as to the adequacy of procedural and organizational safeguards in place at BLM to minimize the risk of fraud. For example, PWCNL instructed the PWCI member firm in Bermuda (“PWC Bermuda”) to meet with BLM in December, 2004:

“in order to obtain and/or update PwC’s understanding of the procedures in place at BLM ... for the purpose of gaining comfort thereon for the audits by several PWC offices of a number of funds having monies managed by BLM. One of these funds is Fairfield Sentry Ltd., audited by PWC Rotterdam.”

This was a follow-up to a previous inspection of BLM.

35. PWCNL represented to the Plaintiffs that, with the assistance of PWC Bermuda, it had gained an “understanding of the internal control framework at BLM.” In particular, PWCNL represented that:

- (a) “risk of fraud is being scrutinized closely”
- (b) there was “segregation of the custodian function from the Advisory and Brokerage functions, (both physically and through access)” at BLM;
- (c) “there is an internal audit department that does periodic review of systems and reconciliations processes. There is frequent reporting to [Bernard Madoff] as well as to the audit committee of BLM”;
- (d) “a number of controls and reconciliations are performed electronically and on a daily basis. The trading process for this strategy ‘split strike conversion’ is also initiated by the system without trader intervention. Trades are bunched and allocated to the accounts on a pro-rata basis”;
- (e) “performance is reviewed by BLM Advisory by analyzing the programmed trading strategy and thereby reviewing the correlative factors. Management can require adjustments and will be responsible for such adjustments”;
- (f) there were “controls in place to ensure that trading levels are maintained within those prescribed in the brokerage agreement”;
- (g) “there have not been any regulatory matters impacting BLM”; and
- (h) “for 2004, a standard clean letter of internal control was issued by BLM’s auditors. PWC has received a copy of this letter.”

36. Pursuant to an engagement letter dated January 11, 2007 (the “2006 Engagement Letter”), PWC undertook to audit the financial statements of Sigma, Lambda and Sentry, respectively, as at December 31, 2006 in accordance with GAAS and applying GAAP in accordance with IFRS.

37. The 2006 Engagement Letter specifically stated:

“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.

...

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.”

38. Upon taking on the audits of the Plaintiffs, the Defendants treated all of the Plaintiffs as continuing clients of the firm, such that they did not conduct as rigorous a client acceptance review as would have been done if the Plaintiffs had been treated as new clients. The Defendants owed duties of care to the Plaintiffs to critically review the work papers of PWCNL, to make inquiries of PWCNL as to issues and concerns with their prior audits and to independently assess the risks of the engagement, including those risks posed by the roles played by BLM. The Defendants breached this duty of care by failing to do so.

39. Both PWC and PWCNL prepared audit plans for their audits of the Plaintiffs. For example, PWC’s audit plan for Fiscal 2006 specifically identified “Bernard Madoff” as “custodian”, “sub-custodian” and “prime broker” for Sentry and represented that:

“through discussion and inquiry with Bernard Madoff, we will obtain an understanding of the key control activities as they relate to the operations and processes over the custodian, sub-custodian and prime broker functions. As these key control activities are not covered in the section 5970/FAS 70 report, we will perform transaction testing on the investment strategy applied by Bernard Madoff for the applicable Funds.”
[Emphasis Added]

40. In its 2006 audit plan, PWC also represented to the Plaintiffs that it would:
- (a) confirm the “existence of investments with both the custodian and respective investment managers”;
 - (b) perform “substantive detail testing of year end dividend and interest income”;
 - (c) “obtain from the Investment Manager performance bench marks for each of the Funds and test fund performance in accordance with the Funds investment objective criteria to form an overall conclusion as to whether the financial statements taken as a whole are consistent with our understanding of the business, by identifying and investigating unusual or unexpected balances, significant fluctuations or relationships (both financial to financial relationships and financial to non-financial relationships) that might indicate a risk of fraud or error”; and
 - (d) engage in subsequent events testing during which it would “review the latest trial balances of the funds to identifying the response to subsequent events potentially affecting the financial statements”.
41. PWC’s audit plan for Fiscal 2006 specifically represented that:

“We are required to consider the risk of material misstatements in the financial statements resulting from fraud or error. When we plan the audit, we make enquiries of management to obtain an understanding of their risk assessment and the procedures in place to prevent or detect fraud or error.”

More particularly, PWC represented that they would carry out, *inter alia*, the following procedures:

- Be aware of conditions generally present to commit fraud and assess risks of fraud throughout the audits
- Evaluate the Investment Manager programs and controls relating to fraud...
- Evaluate business rationale for significant unusual transactions
- Add an element of unpredictability in audit procedures year to year”

42. PWC issued a clean audit opinion dated April 24, 2007 with respect to the financial statements of Sentry for Fiscal 2006. The opinion stated as follows:

“In our opinion, the accompanying balance sheet and the related income statement, the statement of changes in net assets attributable to holders of redeemable participating shares and the cash flow statement present fairly, in all material respects, the financial position of Fairfield Sentry Limited (the “Company”) as of December 31, 2006 and the results of its operations, the changes in its net assets attributable to holders of redeemable participating shares and its cash flows for the year then ended in conformity with International Financial Reporting Standards. These financial statements are the responsibility of the Company’s management; our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these financial statements in accordance with auditing standards generally acceptable in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by the Company’s management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.”

43. In issuing this opinion, PWC expressly relied on the opening balance sheet that had been audited by PWCNL and expressed no reservations in respect of it.

44. In order for PWC to rely upon the audit work of PWCNL, the Defendants were required to satisfy themselves that PWCNL was competent to audit the Plaintiffs’ financial statements, had conducted its audits in accordance with GAAS and had no reservations with respect to the audited financial statements on which it had opined. The Defendants owed the Plaintiffs duties of care to ensure they carried out this requirement. The Defendants failed to do so.

45. PWC issued the same clean audit opinion dated April 24, 2007 with respect to the audited financial statements of Sigma for Fiscal 2006.

46. PWC also issued the same clean audit opinion dated April 24, 2007 with respect to the audited financial statements of Lambda for Fiscal 2006.

47. At no time did the Defendants indicate to the Plaintiffs any concerns with respect to the prior representations of PWCNL, including the clean audit opinions rendered by PWCNL with respect to the Plaintiffs' financial statements for Fiscal 2005 and for prior fiscal years.

48. PWC issued a clean review opinion dated October 17, 2007 for Sentry with respect to the financial statements for the six months ended June 30, 2007.

49. The 2006 Engagement Letter stated that "each engagement with PricewaterhouseCoopers for additional services will be subject to a separate engagement letter..."

50. Pursuant to an engagement letter dated October 17, 2007 (the "2007 Engagement Letter"), Sigma, Lambda and Sentry engaged PWC to audit the annual financial statements of Sigma, Lambda and Sentry, respectively, as at December 31, 2007. PWC undertook to review and audit the 2007 financial statements of Sigma, Lambda and Sentry "in accordance with generally accepted auditing standards in the United States of America."

51. As part of its audit of Sentry's Fiscal 2007 financial statements, recognizing the significance of the relationship between Sentry and BLM, PWC inserted a reference to BLM into the notes to the financial statements:

"As a result of the...selection of Bernard L. Madoff Investment Securities, LLC ("BLM") as execution agent of the split strike conversion strategy, substantially all of the Company's assets will be held in segregated accounts at BLM, a U.S. registered broker-dealer and qualified custodian. Accordingly, BLM will be a sub-custodian of the Company. The services of BLM and its personnel are essential to the continued operation of the Company, and its profitability, if any."

52. PWC issued a clean audit opinion dated April 7, 2008 with respect to the financial statements of Sentry for Fiscal 2007. The opinion stated:

"In our opinion, the accompanying balance sheet and the related income statement, the statement of changes in net assets attributable to holders of redeemable participating shares and the cash flow statement present fairly, in all material respects, the financial position of Fairfield Sentry Limited (the "Company") as of December 31, 2007 and the results of its operations, the changes in its net assets attributable to holders of redeemable participating shares and its cash flows for the year then ended in conformity

with International Financial Reporting Standards. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these financial statements in accordance with auditing standards generally acceptable in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by the Company's management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.”

53. PWC issued the same clean audit opinion dated April 7, 2008 with respect to the audited financial statements of Sigma for Fiscal 2007.

54. PWC also issued the same clean audit opinion dated April 7, 2008 with respect to the audited financial statements of Lambda for Fiscal 2007.

55. PWC issued a clean review opinion dated September 17, 2008 for Sentry with respect to the financial statements for the six months ended June 30, 2008.

56. Pursuant to an engagement letter dated November 7, 2008 (the “2008 Engagement Letter”), PWC undertook to audit the financial statements of Sigma, Lambda and Sentry as at December 31, 2008 “in accordance with generally accepted auditing standards in the United States of America.”

57. PWC and/or other PWCI affiliates also performed audit services for other funds related to Sigma, Lambda and Sentry as well as for other “feeder funds” to BLM, which were not related to the Plaintiffs. For example, PWC Bermuda’s “discussion and enquiry” of Bernard Madoff was circulated to other PWCI affiliates that were auditing feeder funds to BLM (other than the Plaintiffs).

The Criminal Charges

58. Madoff was arrested on December 11, 2008 on criminal charges that he violated federal securities laws by operating a multi-billion dollar “Ponzi” scheme. Upon arrest, Madoff told FBI

agents that there was no innocent explanation for his crimes. On that same day, the United States Attorney for the Southern District of New York filed criminal charges against Madoff for violations of United States securities laws. In addition, the Securities and Exchange Commission (“SEC”) filed a complaint charging that, among other things, BLM committed securities fraud and sought a permanent injunction and the appointment of a receiver for BLM. In short, BLM ceased to operate on December 11, 2008 and began liquidating.

59. On March 10, 2009, the United States Attorney for the Southern District of New York filed a criminal Information against Madoff (the “Information”), which alleged that, among other things, “Madoff failed to honor his promises to [BLM] clients by, among other things, failing to invest the [BLM] investment advisory clients’ funds in securities as he promised.” Further, Madoff “created and caused to be created a broad infrastructure at [BLM] to generate the impression and support the appearance that [BLM] was operating a legitimate investment advisory business in which client funds were actively traded as he promised, and to conceal the fact that no such business was actually being conducted.” Moreover, Madoff caused “[BLM] employees to, among other things, communicate with clients and generate false and fraudulent documents including, but not limited to, monthly account statements and trade confirmations that purportedly reflected the purchases and sales of securities that Madoff claimed had been conducted on behalf of [BLM’s] clients.”

60. On March 12, 2009, Madoff pled guilty to all 11 counts in the Information, namely: (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 activity; (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.

61. As part of his guilty plea, Madoff admitted, among other things, that: (a) his “fraud began in the early 1990s”; (b) he “misrepresented to clients, employees and others, that [he] purchased securities for clients in overseas markets”; (c) he never “executed trades on behalf of [his] investment advisory clients”; and (d) he falsified “trading confirmations and client account statements that reflected the bogus transactions and positions [he] created and sent to clients purportedly involved in the split strike conversion strategy”.

62. On June 29, 2009, Madoff was sentenced to a prison term of 150 years.

The Court-Supervised Liquidation of BLM

63. By order dated December 15, 2008, the United States Court for the Southern District of New York appointed Irving H. Picard, Esq. as the *Securities Investor Protection Act* trustee in charge of the liquidation of BLM (the “SIPA Trustee”).

64. On February 20, 2009, during a public meeting with customers and creditors of BLM held in the United States Bankruptcy Court for the Southern District of New York, the SIPA Trustee reported that his investigation had revealed, among other things, that BLM had not traded or purchased any securities on the account of any customer, including Sentry, for at least the past 13 years. In subsequent pleadings and other court filings, the SIPA Trustee has reconfirmed that, based on his further review of BLM records, BLM did not trade any security on the account of its customers, including the Plaintiffs.

65. Subsequent to the February 20, 2009 meeting, the SIPA Trustee represented in pleadings with the United States Bankruptcy Court that there are no records of BLM having cleared a single purchase or sale of securities on any exchange in connection with the SSC Strategy. The SIPA Trustee has also not found evidence that BLM ever purchased or sold any of the options that Madoff claimed, on customer statements, to have purchased. Further, as noted, Madoff has admitted that he did not trade on the account of any client of BLM.

BLM’s Auditor

66. BLM’s financial statements were purportedly audited by Friebling & Horowitz (“F&H”), a tiny, obscure accounting firm with one active accountant.

67. BLM filed its audited financial statements, annually, with the SEC along with a report on internal controls on which F&H was also required to opine.

68. F&H purported to issue, annually, a boilerplate opinion that it had noted no material weaknesses in the internal controls of BLM and that BLM’s practices and procedures were “adequate” to meet the objectives of U.S. *Securities Exchange Act of 1934* Rule 17a-5(g) (a

“Rule 17 Report”). At the end of each Rule 17 Report, F&H specifically disclaimed the right of any third parties, such as the Plaintiffs and PWC, to rely on its Rule 17 Reports.

69. Nevertheless, the Defendants purported to rely upon the Rule 17 Reports of F&H as part of its audit work for Fiscal 2006 and Fiscal 2007. PWC owed the Plaintiffs a duty of care to satisfy itself that F&H: (a) was independent of BLM; (b) was competent to audit BLM’s financial statements and internal controls; (c) had conducted its audits in accordance with GAAS; and (d) had no reservations with respect to the audited financial statements on which F&H had opined or the Rule 17 Reports. The Defendants breached this duty of care by failing to do so.

70. On March 18, 2009, the SEC charged the auditors of BLM, David G. Friehling (“Friehling”) and his firm, F&H, with committing securities fraud by representing that they had conducted legitimate audits, when, in fact, they had not.

71. On March 18, 2009, the United States Attorney for the Southern District of New York charged Friehling with securities fraud, aiding and abetting investment adviser fraud, and four counts of filing false audit reports with the SEC.

72. On November 3, 2009, Friehling pled guilty to nine criminal charges, including charges that he failed to test internal controls at BLM and made false filings with the SEC with respect to the Rule 17 Reports. At that time, Friehling admitted that he: (a) was not independent of BLM because he had invested a balance of over \$500,000 with BLM since 1995; (b) did not conduct his audits of BLM in accordance with applicable GAAS; (c) did not verify the securities in the custody of BLM; (d) “took at face value” the information supplied by BLM; (e) knew that, contrary to the opinion stated in his audit reports on BLM that were filed with the SEC, he had not independently verified the assets and liabilities of BLM in accordance with GAAS; and (e) falsely represented to the American Institute of Certified Public Accountants (“AICPA”) from 1994 to 2008 that he did not perform any audits.

Duty of Care Owed by PWC

73. PWC knew and intended that the review and audit reports, statements and analyses, which it compiled, represented, reported upon, or assisted as to, were material to the true and fair presentation and understanding of the financial position and affairs of Sigma, Lambda and Sentry.

74. PWC knew and intended that the review and audit reports, statements and analyses, which it compiled, represented, reported upon, or assisted as to, would be relied on by the Plaintiffs and their investors, and they were relied on by the Plaintiffs and their investors.

75. PWC was required to perform its reviews and audits of Sigma, Lambda and Sentry in accordance with applicable GAAS as well as any higher standards set out in their own audit manuals and those of PWCI.

76. In particular, PWC was required to:

- (a) staff the audit or review with personnel having adequate technical training and proficiency in IFRS and GAAS;
- (b) understand the Plaintiffs' business and the industry in which they operate, and identify high risk relationships, such as the one with BLM;
- (c) plan the audit or review with a view to the specific risks posed by the multiple roles of BLM;
- (d) ensure that partners are integrally involved on a timely basis on all material issues related to the audit or review;
- (e) ensure audit staff are, at all times, properly supervised;
- (f) maintain independence;
- (g) exercise due professional care in performing the audit or review;
- (h) obtain sufficient competent evidence to afford a reasonable basis for an opinion regarding the financial statements under audit or review;

- (i) fulfill its responsibilities for the detection and reporting of errors and irregularities;
- (j) perform a proper study and evaluation of existing internal controls at Sigma, Lambda, Sentry and BLM and consider additional testing procedures to address potential deficiencies identified;
- (k) consider, evaluate and disclose the ability of Sigma, Lambda and Sentry to continue as a going concern after critically evaluating the Plaintiffs' investment in BLM;
- (l) appropriately qualify its opinions when an unqualified opinion on the financial statements as a whole could not be expressed; and
- (m) disclose sufficient information to enable the reader to appreciate the nature of the transactions reported upon.

77. In connection with review and/or audit work it performed and as to information supplied to it by Sigma, Lambda, Sentry, Madoff, F&H and/or BLM, PWC was required by applicable GAAP and/or GAAS to:

- (a) consider the materiality and likelihood of significant error or fraud in the information supplied to it;
- (b) evaluate such information with a high degree of professional scepticism to determine whether it was sufficiently relevant and reliable for PWC to draw reasonable conclusions from it;
- (c) consider whether there were any alternative or additional sources of audit evidence;
- (d) consider the relationship between Sigma, Lambda, Sentry and BLM;
- (e) evaluate the competence, independence and reliability of F&H and critically review its audit work before placing any reliance upon its opinions;

- (f) critically review the audit work of PWCNL before placing any reliance upon its opinions;
- (g) obtain relevant and reliable evidence to enable them to prepare the financial information to be included in their reports;
- (h) form an opinion on that information and satisfy itself that all relevant information has been considered with due care;
- (i) issue a qualified review or audit report if it believed that the information it had was insufficient to enable it to draw reasonable conclusions; and
- (j) disclose details of any contingent liabilities.

78. PWC was required under GAAS to carefully consider whether there was a risk that the financial statements it was auditing contained material misstatements due to fraud, to identify the risks thereof and to communicate those concerns, if any, to the directors of Sigma, Lambda and Sentry. In doing so, PWC was required to exercise professional scepticism in gathering and evaluating evidence. PWC was required to conduct its audits and reviews with a mindset that recognized the possibility that a material misstatement due to fraud could be present, regardless of any past experience with Sigma, Lambda, Sentry or BLM.

79. In order to perform their functions, the audit and review teams under Wall's supervision at PWC were required to consider how and where the Plaintiffs' financial statements might be susceptible to material misstatement due to fraud. PWC knew that approximately 100% of Sigma's and Lambda's assets were invested in Sentry. PWC also knew that approximately 95% of Sentry's assets were held by BLM. Consequently, PWC was required to consider how the assets of Sentry in the possession of BLM could have been misappropriated and how such misappropriation might have been concealed by BLM or its agents.

80. PWC was required, by GAAS and GAAP, to satisfy itself that the statements, reports and analyses, which it compiled, presented, reported upon for Sigma, Lambda and Sentry, did not contain material misstatements or omissions of fact.

81. PWC was required to withdraw and/or correct any opinion it had previously issued on the financial statements of Sigma, Lambda and Sentry and/or to correct any statements, forecasts, reports and analyses (or assumptions relating thereto), which it compiled, presented, reported upon, or assisted as to, upon learning that it materially misstated and/or omitted material facts.

GAAS Requirements

82. The AICPA is the professional organization that promulgates the national auditing standards for the United States referred to herein as U.S. GAAS. Through its Auditing Standards Board, the AICPA has, in its Statements of Auditing Standards (“SAS”), codified a detailed interpretation of GAAS.

83. In conducting the audits of the Plaintiffs, PWC had a duty to follow the ten Generally Accepted Auditing Standards established by the AICPA and set out in Section 150.02 of the AICPA Professional Standards (the “Standards”). Section 150.02 of the Standards provides as follows:

General Standards

1. The auditor must have adequate technical training and proficiency to perform the audit.
2. The auditor must maintain independence in mental attitude in all matters relating to the audit.
3. The auditor must exercise due professional care in the performance of the audit and the preparation of the report.

Standards of Field Work

1. The auditor must adequately plan the work and must properly supervise any assistants.
2. The auditor must obtain a sufficient understanding of the entity and its environment, including its internal control, to assess the risk of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures.
3. The auditor must obtain sufficient appropriate audit evidence by performing audit procedures to afford a reasonable basis for an opinion regarding the financial statements under audit.

Standards of Reporting

1. The auditor must state in the auditor's report whether the financial statements are presented in accordance with generally accepted accounting principles (GAAP).
2. The auditor must identify in the auditor's report those circumstances in which such principles have not been consistently observed in the current period in relation to the preceding period.
3. When the auditor determines that informative disclosures are not reasonably adequate, the auditor must so state in the auditor's report.
4. The auditor must either express an opinion regarding the financial statements, taken as a whole, or state that an opinion cannot be expressed, in the auditor's report. When the auditor cannot express an overall opinion, the auditor should state the reasons therefore in the auditor's report. In all cases where an auditor's name is associated with financial statements, the auditor should clearly indicate the character of the auditor's work, if any, and the degree of responsibility the auditor is taking, in the auditor's report.

84. Section 110.02 of the Standards required PWC to exercise due professional care “to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud.”

85. In order to be able to do so, PWC was required by Section 314.01 of the Standards to “obtain a sufficient understanding of the entity and its environment, including its internal controls, as to assess the risk of material misstatement of the financial statements, whether due to error or fraud.”

86. In accordance with Section 332.11 of the Standards, PWC ought to have treated BLM as a “Service Organization” because its services were an integral part of the Plaintiffs’ information system for securities that affected: (a) how the Plaintiffs’ securities transactions were purportedly initiated; and (b) the accounting records, supporting information and specific accounts in the financial statements involved in the processing and reporting of the Plaintiffs’ securities transactions. More particularly, PWC knew or ought to have known that:

- (a) Madoff and BLM represented that all securities transactions conducted pursuant to the so-called SSC Strategy were initiated by BLM’s proprietary software system without trader intervention;

- (b) Madoff was responsible for the ultimate decisions for adjustments to the strategy;
and
- (c) Both the Plaintiffs and their administrator relied on the statements supplied by BLM in order to report to their investors.

87. Section 332.20 of the Standards acknowledges the heightened risk of fraud associated with an investment adviser also serving as sub-custodian:

— If one service organization initiates transactions as an investment adviser and also holds and services the securities, all of the information available to the auditor is based on the service organization's information. The auditor may be unable to sufficiently limit audit risk without obtaining audit evidence about the operating effectiveness of one or more of the service organization's controls. An example of such controls is establishing independent departments that provide the investment advisory services and the holding and servicing of securities, then reconciling the information about the securities that is provided by each department.

88. Given the foregoing and PWC's knowledge that BLM also acted as investment manager, PWC ought to have required more extensive audit procedures to be undertaken at BLM.

89. Since the confirmation of the existence of a security is a critical audit issue, PWC was required to do more than accept a broker statement from BLM as sufficient audit evidence. More particularly, Section 332.16 of the Standards specifically directs that confirmations from service organizations do not constitute sufficient audit evidence.

90. Due to the reliance placed on the audit work of F&H, GAAS and, in particular, Section 543 of the Standards required PWC to:

- (a) make inquiries concerning the professional reputation of the other auditor with one or more of the AICPA, Public Company Accounting Oversight Board (the "PCAOB"), other practitioners and/or bankers;
- (b) obtain a representation from the other auditor as to its independence under the requirements of the AICPA, the PCAOB and the SEC; and

- (c) ascertain through communication from the other auditor that he is aware of the intended reliance by PWC on his report and has conducted his audit appropriately for PWC's purposes.

91. In the event that PWC concluded, as it ought to have, that F&H's reports were not satisfactory, then PWC was directed by GAAS and, in particular, Section 332.30 of the Standards to directly apply appropriate auditing procedures to BLM in order to allow PWC to form an independent conclusion on BLM's internal controls, the existence of the securities purportedly held by BLM, the safeguarding of securities and reporting given that over 95% of the Plaintiff's funds were invested with BLM.

PWC Guide

92. PWC held itself out to the Plaintiffs as being "at the leading edge of best practice," such that the Plaintiffs had a reasonable expectation that PWC would perform its audits having a special expertise in auditing at a higher standard than the minimum required by GAAS.

93. In its publication "Auditing Alternative Investments, A Practical Guide for Investor Entities, Investee Fund Managers and Auditors" (the "PWC AI Guide"), PWC purported to be in a "leadership position as auditors for both investee funds and investor entities." The PWC AI Guide expressly acknowledges the relevance of Section 332 of the Standards to auditing fund clients, such as the Plaintiffs, including the need to perform additional audit procedures because a confirmation alone "does not constitute adequate audit evidence."

94. The PWC AI Guide recognized the "unique audit risks" posed by these investments. Indeed, it is acknowledged that funds, such as the Plaintiffs, would be "high" risk given the "transparency constraints with respect to the ultimate underlying investments." In such circumstances, the PWC AI Guide favours "heavy substantive testing of valuation and existence assertions."

95. The PWC AI Guide mandates PWC to focus on the key questions: "Do the investor entity's alternative investments exist at the financial statement date, and have the related transactions occurred during the period?"

96. PWC was required to know the business of the Plaintiffs in order to properly plan and perform an effective audit. Consequently, PWC was required to gain a sufficient understanding of the SSC Strategy described in the Plaintiffs' Private Placement Memoranda.

Duty of Care owed by Wall

97. Wall knew and intended that the review and audit reports, statements and analyses, which he supervised, compiled, represented, reported upon, or assisted as to, were material to the true and fair presentation and understanding of the financial position and affairs of Sigma, Lambda and Sentry.

98. Wall knew and intended that the review and audit reports, statements and analyses, which he supervised, compiled, represented, reported upon, or assisted as to, would be relied on by the Plaintiffs and their investors, and they were relied on by the Plaintiffs and their investors.

99. Wall was required to perform his review and audit work in respect of Sigma, Lambda and Sentry in accordance with applicable GAAS as well as any higher standards set out in PWC's audit manuals and those of PWCI.

100. In particular, Wall was obliged to satisfy the requirements set out in paragraphs 76(a) to 76(c) and 76(e) to 76(m).

101. In connection with review and/or audit work performed by Wall and the review and audit teams at PWC and as to information supplied to by Sigma, Lambda, Sentry, Madoff, F&H and/or BLM, Wall was obliged by applicable GAAP and/or GAAS to satisfy the requirements set out in paragraphs 77(a) to 77(j).

102. In respect of Wall, the Plaintiffs also repeat and rely on the allegations in paragraphs 78 to 80 and 82 to 91.

103. In addition to requirements under applicable GAAS and GAAP, Wall was required to act, and ensure that the audit and review teams at PWC acted, in accordance with any policies, procedures and representations set out or referenced in the PWC AI Guide, including as particularized in paragraphs 92 to 96.

Particulars of Negligence and/or Breach of Contract by PWC

104. PWC failed to exercise due care and diligence and/or was negligent in conducting its review and audit examinations of the financial statements of Sigma, Lambda and Sentry.

105. In breach of contract and the duties it owed at law, PWC failed to conduct its reviews and audits of the Plaintiffs in accordance with the applicable standards of GAAP and GAAS and the higher standards set out in their audit manuals and those of PWCI. More particularly, PWC:

- (a) failed to ensure the Plaintiffs' financial statements were, in fact, in accordance with applicable principles of GAAP and GAAS as PWC stated in its review and audit reports;
- (b) failed to ensure that the notes to the Plaintiffs' financial statements did not omit a material fact or misrepresent the facts;
- (c) failed to satisfy the minimum acceptable standards of professional conduct in each of its reviews and audits of Sigma, Lambda and Sentry;
- (d) failed to comply with its own internal standards, including those of PWCI, and published standards for proper conduct of an audit or review of a company in the Plaintiffs' industry;
- (e) failed to perform sufficient audit fieldwork to afford itself a reasonable basis for forming an opinion regarding the Plaintiffs' financial statements but regularly issued unqualified audit and review opinions;
- (f) PWC failed to understand the business of the Plaintiffs and, as a result, failed to properly plan and perform its audits and reviews of the Plaintiffs, thereby missing an opportunity to detect the existence and value of the Plaintiffs' actual assets with BLM. More particularly, PWC:
 - (i) failed to gain a full understanding of the SSC Strategy described in the Plaintiffs' Private Placement Memoranda;
 - (ii) ought to have been alarmed when management of the Plaintiffs could not clearly articulate how the strategy worked;

- (iii) failed to get a reasonable explanation as to why the trends in the market always dictated that this supposedly sophisticated strategy purported to place the accounts in Treasury Bills at the end of each reporting period;
- (iv) failed to get a reasonable explanation as to why BLM was achieving consistent double digit returns over time when the underlying S&P 100 Index, upon which the strategy was based, did not; and
- (v) failed to appreciate that the volume of specific securities bought or sold as reported by BLM to the Plaintiffs was not credible because the volume approached or exceeded the volumes reported by the relevant exchange;
- (g) failed to conduct its audits and reviews with a high degree of professional scepticism and with independence in mental attitude;
- (h) failed to investigate and/or resolve the following indices of potential fraud (the “Audit Warning Signs”) which, individually and/or collectively, were material and should have caused PWC to expand the scope of its audit or review work and heighten its level of professional scepticism, such that the existence and value of the Plaintiffs’ actual assets with BLM would be discovered. The Audit Warning Signs include, but are not limited to:
 - (i) in contrast to the fact that most registered investment advisory firms (which BLM was) use third-party custodians to protect against operational risk, BLM required that it maintain custody of the securities in the accounts it purportedly traded and that custody not be with an independent custodian. This lack of segregation of the investment adviser, brokerage and sub-custodian functions resulted in BLM preparing all the reports in respect of activities in the Plaintiffs’ accounts, thereby greatly enhancing the opportunity for fraud to occur. Furthermore, the fact that BLM acted as the investment manager, making all key decisions with respect to the SSC Strategy, only served to magnify the risk that fraud could occur. PWC failed to take into account this significant increase in operational risk in assessing the overall risk, planning and execution of the audit, as was required by applicable auditing standards;

- (ii) creating an environment conducive to fraud, BLM employed Madoff's family members in key positions throughout the business. Madoff was the sole director. His brother, Peter Madoff, had been head of stock trading, head of compliance and responsible for computers and technology. His two sons, Andrew and Mark, held management positions in trading. His cousin, Charles Wiener, had been head of administrative accounts, and his niece, Shana, had been legal counsel;
- (iii) BLM and Madoff represented that they utilized the SSC Strategy of purchasing call and put options for the Plaintiffs' accounts under their management. In violation of its duties under applicable auditing standards, PWC failed to analyze the alleged trading by BLM or to critically assess whether the specific trades scrutinized were credible in light of the conflicting evidence available to it from independent resources as to related volumes and pricing of options;
- (iv) the Sentry PPM, with which PWC was obliged to familiarize itself, stated that options trading may utilize the over-the-counter ("OTC") market, which is subject to counterparty risk. PWC failed to take into account the risk associated with the OTC options in assessing the overall risk, planning and execution of the audit. If PWC performed even minimal audit procedures to assess the credit risk of OTC options trading or even to confirm the contractual terms, it ought to have determined that they did not exist. More particularly, PWC ought to have identified the counterparties to the options trading purportedly being conducted on behalf of the Plaintiffs, reviewed the underlying contracts with those counterparties and confirmed the alleged trades with a sampling of the counterparties;
- (v) The paper trading tickets presented by BLM contained repeated references to CUSIP numbers associated with the option trades as reported. CUSIP numbers were only used in trading on the options exchange. Consequently, the trading tickets presented by BLM were inconsistent

with the SSC Strategy, as described in the Sentry PPM, which contemplated most option trading being over-the-counter;

- (vi) as a broker dealer, BLM had the ability to generate whatever trading tickets it wanted and, because it maintained custody of the securities in the Sentry account, there was no independent verification by a third party that such trading had actually occurred. If PWC had properly reviewed BLM's alleged trading on account of the Plaintiffs, it ought to have discovered that BLM was not trading securities on the account of Sentry, as reported in the account statements;
- (vii) Contrary to common practice, BLM did not allow the Plaintiffs electronic access via the internet to review their accounts. Instead BLM purportedly used paper trade confirmations that it insisted on mailing to the Plaintiffs, such that they were received 3 to 5 days after the trades allegedly took place. This practice was conducive to fraud and particularly suspicious given that BLM represented to PWC Bermuda and PWC that BLM had cutting-edge technology that included an automated order and execution process to implement the SSC Strategy. The practice was also suspicious because the time lag increased the likelihood that fraud could occur. PWC failed to test this automated process or reconcile the paper trading confirmations with the allegedly automated process, as required by applicable auditing standards; and
- (viii) PWC represented to Sentry that it had specialized knowledge, expertise and experience in auditing and accounting with respect to funds, such as Sigma, Lambda, Sentry and BLM, as well as access to public and non-public information as to the operation and results of BLM. The member firms of PWCI, including PWC and PWCNL, share information and services with respect to clients and/or common issues affecting auditing and services provided. This is done in aid of rendering more complete services and to protect PWCI members against, and to reduce the risk of, potential claims by audit clients. Pursuant thereto, PWC, PWCNL and the other member firms of PWCI shared information and/or had access to

each other's information with respect to Madoff and BLM and regarding their respective clients' relationships with Madoff and BLM. PWC failed to resolve the material warnings put forth by other PWCI affiliates and failed to disclose the identified risks to the Plaintiffs. PWC had obligations to investigate, resolve or report on the knowledge and reports concerning Madoff and BLM in its possession and on additional information available from other PWCI members. PWC failed to meet these obligations. These failures were material and in violation of GAAS, GAAP and the internal standards set by PWC and PWCI.

- (i) failed, contrary to applicable GAAS requirements and its own audit manuals and those of PWCI, to satisfy itself that Sigma, Lambda and Sentry had implemented adequate safeguards in the face of known operational risks and the Audit Warning Signs;
- (j) failed to advise Sigma, Lambda and Sentry of the existence and importance of the Audit Warning Signs and PWC's assessment of those Audit Warning Signs after conducting a reasonable, independent investigation;
- (k) acknowledged to Sigma, Lambda and Sentry that PWC was "responsible for planning and performing the audit to obtain reasonable assurance that the financial statements are free of material misstatements, whether caused by error or fraud" and that "fraud may involve collusion and sophisticated and carefully organized schemes designed to conceal it," but PWC failed to approach BLM with the requisite degree of professional scepticism;
- (l) failed to execute the audit plans, which it had represented to Sigma, Lambda and Sentry that it would pursue. PWC acknowledged that it was obliged to assess "the key control activities as they relate to the operations and processes over the custodian, sub-custodian and prime broker functions" and that it would "perform transaction testing on the investment strategy applied by [BLM] for Sigma and Sentry". PWC failed to perform these minimal audit procedures or, alternatively, did not perform them in accordance with applicable standards of GAAS and its own audit manuals;

- (m) failed to approach BLM with professional scepticism and conduct rigorous audit or review procedures at BLM especially in light of: (i) the fact that BLM wore so many hats at the same time as sub-custodian, broker and investment manager; (ii) the note to the 2007 financial statements, which acknowledged that substantially all of the Plaintiffs assets were at BLM and “the services of BLM and its personnel are essential to the continued operation of the [Plaintiffs] and its profitability, if any”; (iii) the involvement of the Madoff family in critical internal control functions; (iv) the restrictions denying the Plaintiffs online access to their accounts and the mailing of paper trading records and broker statements related to the SSC Strategy to the Plaintiffs, even though BLM represented that 99% of such trades were implemented electronically; (v) the obviously superficial and inadequate discussions PWC Bermuda reported having at irregular intervals with Madoff, which PWCNL stated were not directed at providing assurance in respect of internal control or detection of fraud, errors or illegal acts; and (vi) the failure by PWC to conduct the necessary audit work to be able to rely on any reports from F&H;
- (n) failed to appropriately increase its audit or review procedures with respect to Madoff and BLM as a result of its awareness of press articles that pointed out that “some on Wall Street remain sceptical about how Madoff achieves such stunning double-digit returns”;
- (o) failed to investigate and independently confirm, as required by applicable auditing standards, the accuracy of representations by Madoff and BLM and, in particular, the false representations from Madoff and BLM that:
 - (i) the risk of fraud was being “scrutinized closely”;
 - (ii) BLM had properly segregated its investment manager, broker, and sub-custodian functions;
 - (iii) BLM had segregated the Plaintiffs’ investment;
 - (iv) BLM had an internal audit department conducting periodic reviews of systems and reconciliation processes;

- (v) BLM had an audit committee that received and reviewed frequent reports from BLM's internal audit department;
- (vi) internal control procedures at BLM were adequate;
- (vii) BLM was implementing the SSC Strategy on behalf of the Plaintiffs;
- (viii) BLM was conducting trades on behalf of the Plaintiffs in compliance with the trading restrictions in place;
- (ix) block trades were being fairly allocated to the Plaintiffs' accounts;
- (x) at year end, the Plaintiffs' account held Treasury Bills on deposit with the Bank of New York;
- (xi) at other times of the year, the Plaintiffs' account held securities on deposit with the Depository Trust Company;
- (xii) there were no "regulatory matters impacting BLM";
- (xiii) F&H conducted annual audits of BLM in full compliance with applicable GAAS;
- (xiv) F&H conducted separate annual audits on BLM's internal controls in accordance with GAAS and applicable regulatory requirements;
- (xv) F&H conducted regular quarterly verifications of the securities in BLM's possession in accordance with applicable regulatory requirements;
- (xvi) F&H was independent of BLM and Madoff within the meaning of applicable GAAS;
- (xvii) F&H was a reputable, substantial and competent public accounting firm;
- (xviii) F&H was in compliance with American Institute of Certified Public Accountants ("AICPA") requirements for public accounting firms conducting audits; and
- (xix) F&H was registered and in compliance with requirements of the PCAOB.

- (p) improperly placed any reliance upon BLM's financial statements purportedly audited by F&H and/or the Rule 17 Reports of F&H or, in the alternative, placed undue and unreasonable reliance thereon because:
- (i) the BLM financial statements only purported to report on the assets held by BLM, as beneficial owner, and not the assets held by BLM in its capacities as broker-dealer, investment adviser or sub-custodian;
 - (ii) the Rule 17 Reports were not as comprehensive or reliable as SAS No. 70 audit reports, such as were provided in respect of the fund administrator. Given that the internal controls and safeguards at BLM were at least as important to the Plaintiffs as those at the fund administrator, PWC ought to have required an SAS No. 70 report on BLM or conducted the equivalent audit procedures itself;
 - (iii) PWC's failure to critically assess the independence of F&H caused it to miss the opportunity to determine that F&H was not independent of BLM for GAAS purposes because of the significant beneficial holdings its principals maintained with BLM and because F&H performed bookkeeping functions for BLM;
 - (iv) PWC's failure to critically assess the independence and competence of F&H caused it to miss the opportunity to determine that F&H was not qualified to conduct an audit of BLM. PWC ought to have had a heightened concern about checking the credentials of small auditing firms engaged in the investment fund industry in light of the 2005 fraud uncovered at Bayou Group hedge fund, which had been allowed to carry on, in part, due to the use of a small, obscure auditing firm purporting to be an independent auditor;
 - (v) under the regulations of the AICPA, every accounting firm that does auditing work is required to enrol in the AICPA's peer review program, under which experienced auditors assess such firm's audit quality yearly. While F&H was a member of the AICPA, it had not been subjected to a peer review since 1993 because F&H had represented to the AICPA, in

writing, that it did not perform any audits. Whether a firm has been subject to a peer review and the results of any such review are on public file at the AICPA. PWC failed to perform this perfunctory check before placing reliance upon F&H's reports;

- (vi) PWC's failure to obtain access to and critically review the working papers of F&H caused it to miss the opportunity to reveal that F&H had, in fact, never conducted a proper GAAS audit of BLM or its internal controls; and
- (vii) PWC's failure to demand direct access to BLM's records and personnel in order to perform its own critical review of BLM's internal controls and trading records in light of the obvious inadequacies in F&H's independence, competence and diligence and the need, which PWC had identified in its audit plans, to analyze the internal controls at BLM related to the Plaintiffs' assets in BLM's possession as sub-custodian;
- (q) failed to properly assess BLM's solvency and, thereby, neglected to advise that BLM was insolvent;
- (r) failed to determine whether the obligations of BLM to Sigma, Lambda and Sentry were being fully, accurately and honestly discharged;
- (s) issued unqualified reports which, *inter alia*, attested to the accuracy of the Plaintiffs' financial statements and Net Asset Value calculations ("NAV's"), which it ought to have known were materially misleading and overstated;
- (t) failed to properly audit or review the approximately 5% of Sentry's assets that were supposed to be invested with an entity other than Madoff. More particularly, PWC failed to uncover and disclose the investment of a significant portion of these funds with Madoff and BLM;
- (u) failed to obtain and critically analyze available information from available sources, including: (i) the books and financial records of Sentry, Sigma and Lambda; (ii) the directors of Sentry, Sigma and Lambda; and (iii) the records relating to Sigma, Lambda, Sentry and BLM in the possession of Fairfield Greenwich (Bermuda) Limited;

- (v) failed to review and assess the oversight practices and procedures utilized by the investment manager and/or fund administrator and modify their audit or review approach to address any identified weaknesses;
- (w) in order to obtain reasonable assurance that its clean audit or review opinions were reasonable, ought to have required access to BLM records and personnel and critically assessed its operations but failed to do so;
- (x) improperly relied on the inadequate work of PWC Bermuda and other PWCI affiliates;
- (y) improperly relied upon the inadequate work of PWCNL;
- (z) failed to staff the audits and reviews of the Plaintiffs with “an engagement team with the correct industry and technical skills” contrary to its express representation that it would do so and contrary to the standards of applicable GAAS. More particularly, no member of the team was qualified as a U.S. accountant or had significant experience in applying GAAS. Also, PWC did not engage a PWCI member firm in the United States or any other firm to provide that expertise;
- (aa) failed to retain and consult with appropriate specialists and experts. More particularly, PWC failed to engage specialists familiar with the regulatory and auditing framework applicable to the Plaintiffs and BLM;
- (bb) failed to properly supervise the audit or review staff. More particularly, Wall failed to attend key meetings and failed to review and sign off on key audit documents prior to the release of the Plaintiffs’ audited financial statements; and
- (cc) ought to have: (i) gathered more comprehensive knowledge of BLM and its operations from PWCI affiliates performing audit engagements for other audit clients that had significant investments with BLM, whether related to the Plaintiffs or not; (ii) shared information with other PWCI affiliates also auditing entities with significant assets at BLM in order to more critically assess the credibility and consistency of the story being told by BLM; (iii) raised concerns

about scope limitations placed on any PWCI affiliate in fully and critically examining the operations of BLM; (iv) regarded representations of BLM as investment manager, broker and/or sub-custodian with a higher degree of professional scepticism as a consequence of PWCI's collective information, which cast doubt upon BLM's credibility and integrity; and (v) performed more substantive testing at BLM as a consequence of stepping back and critically assessing BLM.

106. As a direct consequence of the negligence and breach of contract particularized above, PWC missed repeated opportunities to determine the existence and value of the Plaintiffs' actual assets with BLM, thereby causing Sigma, Lambda and Sentry damage.

107. An audit or review properly performed in accordance with applicable GAAS and the higher standards in the audit manuals of PWC and PWCI ought to have uncovered the "Ponzi" scheme being conducted by BLM and BLM's insolvency.

Particulars of Negligence by Wall

108. Wall failed to exercise due care and diligence and/or was negligent in supervising the review and audit teams at PWC and in conducting his review and audit examinations of the financial statements of Sigma, Lambda and Sentry.

109. In breach of the duties owed at law, Wall failed to supervise the review and audit teams at PWC and to conduct his reviews and audits of the Plaintiffs in accordance with the applicable standards of GAAP and GAAS and the higher standards set out in PWC's audit manuals and those of PWCI.

110. More particularly, in respect of Wall, the Plaintiffs repeat and rely on the allegations in paragraph 105, including that Wall failed to properly act on the acknowledgements and representations of PWC listed therein.

111. As a direct consequence of the negligence particularized herein, Wall missed repeated opportunities to determine the existence and value of the Plaintiffs' actual assets with BLM, thereby causing Sigma, Lambda and Sentry damage.

112. An audit or review properly performed by Wall and, under his supervision, the review and audit teams at PWC in accordance with applicable GAAS and the higher standards in the audit manuals of PWC and PWCI ought to have uncovered the “Ponzi” scheme being conducted by BLM and BLM’s insolvency.

Damages

113. By reason of all of the foregoing, PWC breached its contracts with Sigma, Lambda and Sentry and/or the Defendants breached the duties of care owed to Sigma, Lambda and Sentry in negligence, thereby causing them damage.

114. The Plaintiffs state that, in reliance on the clean audit and review opinions issued by PWC for Fiscal 2006 and Fiscal 2007, which verified the existence and value of the assets in the custody of BLM, the Plaintiffs continued to operate and incur additional liabilities to third parties and investors continued to maintain or increase their investments in the Plaintiffs. The Plaintiffs assert that PWC’s issuance of each of these separate clean audit and review opinions was the proximate cause of the damages that were incurred subsequently.

115. The Plaintiffs damages caused by its reasonable reliance on the clean audit and review opinions negligently issued by PWC include, but are not limited to:

- (a) continuing to incur new liabilities after the Defendants ought to have warned the Plaintiffs of the non-existence of the assets purportedly held by BLM as sub-custodian, the non-occurrence of the transactions purportedly involving assets of the Plaintiffs and other aspects of the fraud affecting their investments;
- (b) continuing to accept payments from BLM on account of redemptions that were based upon fictitious and inflated NAVs, thereby exposing the Plaintiffs to a \$3 billion claim in bankruptcy from the estate of BLM, after the Defendants ought to have warned the Plaintiffs of the non-existence of the assets purportedly held by BLM as sub-custodian, the non-occurrence of the transactions purportedly involving assets of the Plaintiffs and other aspects of the fraud affecting their investments;

- (c) continuing to pay out redemptions to investors in the Plaintiffs based on fictitious and inflated NAVs with funds received from BLM and with funds received on account of new subscriptions, after the Defendants ought to have warned the Plaintiffs of the non-existence of the assets purportedly held by BLM as sub-custodian, the non-occurrence of the transactions purportedly involving assets of the Plaintiffs and other aspects of the fraud affecting their investments;
- (d) continuing to accept new subscriptions from investors in the Plaintiffs after the Defendants ought to have warned the Plaintiffs of the non-existence of the assets purportedly held by BLM as sub-custodian, the non-occurrence of the transactions purportedly involving assets of the Plaintiffs and other aspects of the fraud affecting their investments;
- (e) continuing to pay fees to BLM, various Fairfield entities and their management, the fund administrator, PWC and others after the Defendants ought to have warned the Plaintiffs of the non-existence of the assets purportedly held by BLM as sub-custodian, the non-occurrence of the transactions purportedly involving assets of the Plaintiffs and other aspects of the fraud affecting their investments;
- (f) maintaining investments with BLM after the Defendants ought to have warned the Plaintiffs of the non-existence of the assets purportedly held by BLM as sub-custodian, the non-occurrence of the transactions purportedly involving assets of the Plaintiffs and other aspects of the fraud affecting their investments;
- (g) making further investments with BLM after the Defendants ought to have warned the Plaintiffs of the non-existence of the assets purportedly held by BLM as sub-custodian, the non-occurrence of the transactions purportedly involving assets of the Plaintiffs and other aspects of the fraud affecting their investments;
- (h) costs associated with regulatory investigations and charges relating to BLM that could have been avoided or, at least, diminished if the Defendants had warned the Plaintiffs on a timely basis of the insolvency of BLM and/or the frauds at BLM affecting their investments; and

- (i) other incremental costs incurred by the Plaintiffs as a result of the failure of the Defendants to warn the Plaintiffs on a timely basis of the insolvency of BLM or the frauds affecting their investments.

116. In the alternative, the Plaintiffs assert that the collective losses of their investors incurred after the Defendants ought to have warned Sigma, Lambda and Sentry of the non-existence of the assets purportedly held by BLM as sub-custodian, the non-occurrence of the transactions purportedly involving assets of Sigma, Lambda and Sentry and other aspects of the fraud affecting their investments.

May 28, 2012

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Court File No: CV-12-454648

Plaintiff

Defendants

**ONTARIO
SUPERIOR COURT OF JUSTICE**

Proceeding commenced at Toronto

STATEMENT OF CLAIM

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