To Be Argued By:
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New York Supreme Court

APPELLATE DIVISION—FIRST DEPARTMENT

1650 BROADWAY ASSOCIATES, INC., ELLEN STURM, GST EXEMPT STURM FAMILY TRUST, GST NONEXEMPT STURM FAMILY TRUST, ELLEN STURM, GST EXEMPT STURM FAMILY TRUST, GST NONEXEMPT STURM FAMILY TRUST,

Plaintiffs-Appellants,

—against—

KENNETH STURM, GETZEL SCHIFF & PESCE, LLP, JOHN DOES 1-10, ABC CORPORATIONS 1-10,

Defendants-Respondents.

CASE NO. 2023-02815

REPLY BRIEF FOR PLAINTIFFS-APPELLANTS

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PRELIMINARY STATEMENT

Plaintiffs-Appellants (i) Ellen Sturm, the GST Exempt Family Trust, and the GST Non-Exempt Family Trust, derivatively on behalf of 1650 Broadway Associates Inc. d/b/a Ellen's Stardust Diner; (ii) 1650 Broadway Associates Inc. d/b/a Ellen's Stardust Diner (the "Diner"); and (iii) Ellen Sturm ("Ellen"), the GST Exempt Family Trust (the "Exempt Trust"), and the GST Non-Exempt Family Trust (the "Non-Exempt Trust"), individually as shareholders of the Diner (collectively, "Plaintiffs") respectfully submit the following reply brief in further support of Plaintiffs' appeal of the order of the Hon. Andrew Borrok, J.S.C., dated April 24, 2023 and entered April 28, 2023 (hereinafter referred to as the "Order"), which granted defendant Getzel Schiff & Pesce LLP's ("GSP") motion to dismiss the Amended Complaint of Plaintiffs.

GSP's responding appeal brief presents just another example of GSP's ignoring obvious facts in its effort to avoid responsibility for advancing the interests of one client, Kenneth Sturm ("Kenneth") over the interests of its other clients, Plaintiffs, when faced with the obvious fraudulent and self-enriching scheme Ken undertook during the course of GSP's representation of Kenneth, Plaintiffs, and various other entities owned and/or controlled by Kenneth. Among the many facts that GSP attempts to gloss over, ignore, or disassociate from, the following inescapable facts must guide this Court in addressing whether it was improper for

the motion to court to grant GSP dismissal of Plaintiffs' action at the pleading stage pursuant to CPLR 3211, given the liberal pleading permitted by New York law and the many disputed material questions of fact presented in the record.

First, despite attempting to blame Ellen for not learning of her son's fraud, claiming the loans were apparent in the Diner's financial statements and tax returns, GSP cannot distance itself from its own admission that prior to 2019 Ellen *was not aware* of those loans. This admission, while acknowledged by the motion court, was ignored in its analysis of the dismissal motion. Further, GSP cannot avoid the implications of its own admission that it agreed to give Ellen a yearly summary of the Diner's finances and her personal finances (services that were not included in the yearly engagement agreements) and between 2012 and 2019, never advised her that Ken, another GSP client, was taking millions of dollars in "loans" and using those funds to engage in his own self-serving business projects. This portion of the record alone warrants reversal of the motion court's order for all causes of action.

Second, GSP self-servingly, and without support, asks this Court to accept its view that its representation of Kenneth, Ellen, the Diner and the other Sturm-related entities posed no conflict of interest when Kenneth took money from the Diner for himself, saddling the Diner with an uncollectable debt and imposing taxes, penalties, and other economic losses on Ellen. GSP was the one entity that had access to all the necessary information that would evidence Kenneth's schemes and fraudulent

loans, and certainly understood that potential risks posed to Ellen and the Diner were Kenneth left to his own devices. But GSP did nothing, said nothing, and admittedly knew Ellen was completely unaware of the theft Kenneth was engaging in over the course of many years. While there is limited case law in New York on what constitutes an accounting conflict of interest in the context of an accounting malpractice cause of action, it is respectfully submitted that under the facts in this record, this Court should make clear to the accounting professionals of New York they cannot elevate one client's interests over that of another client and keep the harmed client in the dark. Clients such as Ellen place their trust in accountants to exercise their professional judgment when handling matters of immense financial importance. In this case, GSP abandoned its obligations to Ellen and ignored the obvious and repeated theft that was being done by its own client, that is, Ken.

As such, for the reasons stated herein and in Plaintiffs' moving brief, the motion court's Order dismissing this matter as against GSP should be reversed and this matter should be remanded to the motion court so that the parties can pursue discovery.

RESPONSE TO GSP'S COUNTER STATEAMENT OF FACTS[1]

As is set forth in the FAC, and contrary to GSP's assertions, Ellen was a mere figurehead for the Diner and was not involved in its finances from and after the time of her husband Irving's death in September 2010, and, from and after that time, Kenneth handled all of the Diner's day-to-day operations, had full responsibility for supervising, managing, and accounting for the Diner's books and records, and was the primary signatory for all checks, disbursements, and other financial transactions. (R. 121 at ¶¶ 23-27). Further, to the extent that the extent and nature of Ellen's involvement with the Diner's financial affairs is an issue, for purposes of a motion to dismiss, the plaintiff's pleadings must be accepted as true. Johnson v. Proskauer Rose LLC, 129 A.D.3d 59, 67 (1st Dept. 2015).

GSP also mis-quotes Ellen regarding the incorporation of the Diner as a New York corporation: while Ellen's Affidavit does state, in ¶8, that Ellen decided to move the Diner to its current location (R. 2427), it does not state that Ellen was the one who decided to incorporate it. Rather, the Affidavit states that "we incorporated the Diner," (Id.) making it clear that this was not Ellen's decision alone and leaving open the issues of who made the decision and what professional advice, if any, was involved in the decision-making process.

[1] GSP's Counter Statement Of Facts presents a number of "facts" that Plaintiffs object to, which are set forth herein. Plaintiffs do not waive any arguments or rebuttal to any facts that are not directly stated herein and in fact objects to the entirety of GSP's Counter Statement of Facts.

GSP asserts that "Plaintiffs and Kenneth Sturm were provided the work Getzel prepared." (Brief p. 5, R. 154 ¶18). However, that is not the case. There is no dispute that all GSP's engagement letters and work product (i.e., financial statements and tax returns) were sent to Kenneth's attention at the Diner's address. (R 118, 121, 124 at ¶¶4, 27, 40; R. 304-328*).*

ARGUMENT[2]

I. Plaintiffs Adequately Pled that GSP Committed Malpractice

The gravamen of Plaintiffs' claims against GSP for malpractice, including claims relating to conflicts of interest, is that GSP was fully aware that (a) Kenneth was taking enormous sums of money out of the Diner and booking them as "loans;" (b) because GSP acted as the accountant for Kenneth personally and for his businesses, GSP was aware that (i) the "loans" were not authorized by Ellen; (ii) Kenneth would be unable to repay the "loans;" (iii) the "loans" were being used for non-Diner purposes (i.e., Kenneth's other businesses); and (c) Ellen was unaware of

[2] GSP asserts, that it is not waiving the statute of limitations argument it made before the Motion Court under CPLR 3211(a)(5) nor previously asserted arguments of lack of standing. (Br. at 19, fn 3). We submit that these assertions are not preserved as the Motion Court's Decision and Order dismissed the claims against GSP for failure to state a claim under CPLR 3211(a)(7) and specifically found that Plaintiffs have standing. First, GSP did not cross-appeal the ruling finding standing and therefore this Court has no power to reverse it. See Hecht v. City of New York, 60 N.Y.2d 57, 61–62, 454 N.E.2d 527, 529 (1983). Second, as to the statute of limitations issue, the Motion Court's failure to grant dismissal on the statute of limitations basis evidences that the motion court denied that argument and, thus because GSP did not cross-appeal the Motion Court's failure to dismiss on statute of limitations grounds, those claims also are lost and this Court should not condone the belated attempt to preserve those arguments.

Kenneth's conduct. Further, GSP met with Ellen at her personal residence on an annual basis, which was outside the scope of GSP's engagement letters, and gave her a broad summary of the Diner's finances, but, year after year, as the amount of "loans" Kenneth had taken grew ever larger, eventually reaching $12 million, never mentioned the "loans" or other misconduct to Ellen. In sum, GSP was serving multiple masters: the Diner, Ellen, the Plaintiff trusts, Kenneth, and Kenneth's businesses. Given the above, under the AICPA Code of Professional Conduct and other applicable law, which GSP was obligated to follow, there was an inherent conflict of interest because Kenneth obviously wanted to keep his "loans" secret from Ellen and to continue to use the Diner as a source of funding for his businesses, but Kenneth's "loans" and other financial misconduct were sapping most or all of the Diner's capital and limiting the ability to pay dividends to the Diner's shareholders. The mere fact that Ellen's new accountants pointed out Kenneth's "loans" immediately demonstrates what an accountant that did not have these conflicts would and should do.

As Plaintiffs' pleadings more than adequately demonstrate, GSP's assertion that it had no professional obligations beyond preparation of tax returns and financial statements is not correct and is contrary to the law and the codes that govern accountant conduct.

GSP alleges that Plaintiffs falsely are claiming "that Getzel 'admitted' to not providing Plaintiffs with notice of the Loans" in an email that is cited by Plaintiffs. In that email, which was sent by Jeffrey Getzel of GSP to Kenneth and Ellen on August 7, 2019, after Ellen had hired new accountants who had advised her of the loans, Mr. Getzel stated:

> I think the bottom line here is that Ellen, rightfully so, is upset that these loans were taken *without her knowledge and approval*.

(R. 2435) (emphasis added).

By admitting that Ellen had no knowledge of the loans, Mr. Getzel was also admitting that, despite his holding yearly meetings with Ellen to discuss the tax returns and financial statements, he never had told her about these loans. Obviously, had Mr. Getzel actually advised Ellen of the loans as they were being taken, she would have known about them before she hired a new accountant in 2019.

GSP also asserts as a defense to its own malpractice that Ellen breached her duties as an officer of the Diner to review "corporate documents" (citing Grika v. McGraw, 55 Misc. 3d 1207(A), 57 N.Y.S.3d 675 (N.Y. Sup. 2016) and BCL §§ 715 and 717). However, to the extent that an officer of a New York corporation may have fiduciary duties, those duties are owed to the corporation and its shareholders, not its accountants. See McBride v. KPMG Int'l, 135 A.D.3d 576, 579, 24 N.Y.S.3d 257, 262 (1st Dept. 2016); Quasha v. Am. Nat. Beverage Corp., 171 A.D.2d 537, 537, 567 N.Y.S.2d 257 (1st Dept. 1991)). Regardless of whether Ellen had an

obligation to review the Diner's financial statements, or was entitled to rely on the professionals she retained to prepare such statements, it is clear that GSP electively had undertaken to meet with Ellen to go over the documents they had prepared and failed, year after year, to point out the huge sums that said officer's child was taking out of the corporation without her knowledge.

We note further that an officer or director is entitled to rely on information presented by public accountants (BCL §§ 715(h) and 717(a)), and any individual director's fiduciary duties are "a relative concept, depending on the kind of corporation involved, the particular circumstances and the corporate role of the director." Editors Notes, BCL § 717. Plaintiffs have alleged that, since 2010, Ellen's role was as a figurehead, with Kenneth handing the Diner's day-to-day operations and finances. R. 121-122 (FAC ¶¶ 24-27). Hence, while we submit that what duties Ellen did or did not have as a director and officer of the Diner is not relevant to the issue of whether GSP breached its obligations to Plaintiffs, we also note that on a motion to dismiss, it is not possible to determine the extent to which Ellen may have had any obligations or even the requisite experience to competently review the Diner's financial statements and tax returns.

Given the above, and for the reasons set forth in Plaintiffs' initial appeal brief, we respectfully submit that the conflict of interest posed by GSP's concurrent representation of Kenneth, on the one hand, and Plaintiffs, on the other hand,

presented the very type of conflict of interest that required at a minimum, disclosure of the "loans" by GSP to Ellen directly or a recusal from further services. The malpractice that is evident is that GSP did nothing other than continue to collect its fees, witness Kenneth's theft, and keep Ellen in the dark. As such, we respectfully submit that the motion court's Order must be reversed.

II. GSP's Engagement Letters Required It to Disclose the Loans

In various parts of its brief, GSP makes much of the fact that it did not handle the Diner's bookkeeping, and that its engagement letters contain language to the effect that the customer is responsible for preventing and detecting fraud and that GSP's engagement is not for the purpose of assessing fraud risk.

However, GSP omits that its engagement letters require GSP to disclose to the appropriate level of management any fraud or illegal activities that it becomes aware of. Specifically, each of GSP's engagement letters dated February 27, 2012, February 8, 2013, March 10, 2014, and March 13, 2016 states as follows:

> [W]e will inform the appropriate level of management of any … evidence or information that comes to our attention during the performance of our compilation procedures that indicates fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our compilation procedures regarding illegal acts that may have occurred, unless they are clearly inconsequential.

(R. 305, 308, 311, 314, 317).The engagement letter dated February 7, 2018, which provided for the preparation of reviewed (as opposed to compiled) financial

statements and tax returns for 2017 and 2018, contains the same language, but with "review procedures" substituted for "compilation procedures." (R. 316-318).

Hence, under the express terms of the engagement letters, GSP had a contractual obligation to disclose the "loans" that Kenneth was taking. As is noted above, GSP was aware that Ellen had no knowledge of the "loans," the "loans" were enormous sums when compared to the Diner's income and assets, and, through their accounting services provided to Kenneth and his companies, GSP was aware that Kenneth likely never would be able to repay the "loans," in other words, that the "loans" involved fraud on Kenneth's part.

We note, further, that New York Courts have held that accountants who discover wrongdoing in the course of their services are required to disclose that wrongdoing to the appropriate members of the client's management. For example, in Nate B. & Frances Spingold Found. v. Wallin, Simon, Black & Co., 184 A.D.2d 464, 465, 585 N.Y.S.2d 416, 417 (1st Dept. 1992) (cited in Plaintiffs' brief at page 18), the Court denied the defendant accountants' motion to dismiss because the allegations against them included (a) knowledge and concealment of illegal acts and diversions of funds and (b) failure to withdraw in the face of a conflict of interest created by the firm's representation of both the plaintiff and the law firm to which a director of the plaintiff company had diverted embezzled funds. See also JAG Orthopedics, P.C. v. AJC Advisory Corp., 48 Misc. 3d 1213(A), 18 N.Y.S.3d 579

(Sup. Ct. Kings Co. 2015) (denying motion to dismiss where plaintiff alleged that accountants retained to prepare tax returns failed to disclose employee theft that was evident in documents used to prepare returns).

III. GSP Had a Conflict Of Interest That Required It to Withdraw

GSP cites Deane v. Brodman, 192 A.D.3d 577 (1st Dept. 2021) for the proposition that the claims against GSP were properly dismissed pursuant to CPLR 3211 because of Plaintiffs' alleged failure to identify the applicable professional standards that would have required GSP to withdraw its representation due to its conflict of interest or to disclose the "loans" to Ellen. The case, however, is wholly distinguishable from the case at bar. The Deane case did not involve allegations of conflict of interest, nor did it involve accountants who were representing multiple clients with conflicting interests. Rather, all the claims addressed in the Deane case were based on the single allegation that certain transactions had not been approved in accordance with the requirements of an operating agreement, and that the accountants had not pointed out that fact to the plaintiffs. Id. at 577, 578. Further, the Deane case involved a dismissal on a motion for summary judgment, not a motion to dismiss. Id. at 577. As such, the case has no bearing in this appeal.

Regarding GSP's assertion that Plaintiffs' brief does not adequately state exactly what standard was violated by GSP's conduct, Plaintiffs' moving brief at pages 16-22 sets forth in detail both case law where motions to dismiss filed by

accountants and accounting firms were denied based on knowledge of misconduct and/or conflicts of interest, as well as the various provisions of the AICPA Code of Professional Conduct that were violated by GSP's conduct. As is noted in detail in Plaintiffs' brief, the AICPA Code is clear about the need for an accountant to "maintain objectivity and be free of conflicts of interest in discharging professional responsibility." AICPA Code § 55, art. IV, R. 132 (FAC ¶84).

As is set forth above and in the brief, in light of GSP's admitted knowledge that Ellen was unaware of the "loans," and the extent of the "loans" as compared to the Diner's income and assets, GSP had an obligations (a) to point out the "loans" to Ellen in her capacity as a member of management of the Diner both under GSP's engagement letters and under general legal principles and (b) to point out the "loans" to Ellen as part of its duties assumed by holding annual meetings with Ellen that were not part of the services covered by GSP's engagement letters with the Diner and (c) owed obligations to Ellen and the two trust Plaintiffs as clients of GSP separate and apart from the Diner.

Further, GSP attempts to distinguish the case at bar from Warshaw v. Mendelow, (Sup. Ct. New York Cty 2011) (cited at page 17 of Plaintiffs' brief) by asserting that (a) the "loans" to Kenneth were disclosed in the tax returns and financial statements that GSP prepared and (b) GSP did not receive any benefit from its misconduct. However, as is fully set forth in Plaintiffs' brief, GSP had an

obligation to specifically point out the "loans" to Ellen based on (i) GSP's contractual obligation to make sure the proper members of management were aware of the "loans," (ii) GSP's obligations owed to Ellen individually, Ellen as Trustee of the GST Exempt Sturm Family Trust, and Ellen as Trustee of the GST Nonexempt Sturm Family Trust, each in their capacities as clients of GSP separate and apart from the Diner, in light of nature and extent of the "loans" to Kenneth, (iii) GSP's decision to conduct in person meetings with Ellen, outside the scope of its engagement letters, and (iv) GSP's actual and admitted knowledge that Ellen was unaware of the "loans." Such facts preclude the argument that GSP did not violate any obligations to Ellen to advise her as to the "loans."

GSP's attempt to distinguish Nate B., 184 A.D.2d 464, (cited above and in Plaintiffs' brief at page 18) on the grounds that the loans were set forth in the tax returns and financial statements is incorrect. As is set forth above, the issue is not how the tax returns and financial statements were prepared, but GSP's separate obligations of disclosure under its engagement letters and as part of its duties to Ellen and the Plaintiff Trusts as clients separate and apart from the Diner.

As to GSP's attempt to distinguish 1136 Tenants' Corp. v. Max Rothenberg & Co., 36 A.D.2d 804, 319 N.Y.S.2d 1007 (1st Dept. 1971) (cited in Plaintiffs' brief at page 18), it is true that, unlike the case at bar, in 1136 Tenants' Corp. the information that the defendant accountants had failed to disclose to their client was

that documents were missing. But the larger point of 1136 Tenants' Corp. is that, as the Court stated that, even though the defendant accounting firm had been retained solely to prepare tax returns, because it was "beyond dispute" that the accounting firm was aware of a material problem, it had a duty to inform its client of the situation. So too here, where, because GSP was aware of the existence and extent of the "loans" and the fact that Ellen was unaware of them, GSP had a duty to point them out to Ellen.

As to GSP's claim that GSP did not benefit from its conduct, the benefit is obvious – as a result of its failure to withdraw from the representation of one of its two client groups that had diametrically differing interests in the "loans," i.e., Kenneth and his own companies on the one hand, which benefitted from the "loans," and the Diner, Ellen, and the two trust Plaintiffs on the other hand, which were injured by Kenneth's stripping the Diner of capital, GSP was able to charge fees to a group of clients that it should not have been representing.

IV. Plaintiffs Adequately Pled Aiding and Abetting Fraud

Plaintiffs appeal brief makes clear why Plaintiffs adequately pled aiding and abetting fraud against GSP, and why disclosure of the "loans" to Kenneth in the financial statements and tax returns is insufficient to require the dismissal of that claim. However, GSP attempts to avoid facing discovery on this issue based on mischaracterizations of applicable law and the record.

First, GSP asserts that the Court in Harbinger Cap. Partners Master Fund I, Ltd. v. Wachovia Cap. Markets, LLC, 27 Misc. 3d 1236(A), 910 N.Y.S.2d 762 (Sup. Ct. NY Cty 2010) ruled that the plaintiff lenders had adequately pled a claim for aiding and abetting fraud against accounting firm BDO Seidman LLP ("BDO") so as to avoid dismissal on a motion to dismiss because BDO had been engaged to perform an audit and "an audit has a higher level of independent verification and analysis." However, in Harbinger, BDO did not request dismissal of the aiding and abetting claim based on an assertion that knowledge of falsity was not adequately pled, and neither the section of the opinion addressing the aiding and abetting claim against BDO, nor any other part of the opinion, addresses audit standards. Rather, BDO requested dismissal of the aiding and abetting claim only on the grounds that (a) Pennsylvania law did not recognize such a tort and (b) if the court determined that New York law applied, the plaintiffs had failed to allege intent to injure the plaintiff and detrimental reliance. Id. at *14. The court denied the motion to dismiss on the grounds that "BDO knew not only that its audit opinions would be provided to the lenders, but that the lenders would directly and expressly rely on the content of those reports in determining to provide credit."

Second, GSP similarly asserts that Fraternity Fund Ltd. v. Beacon Hill Asset Mgmt., LLC, 479 F. Supp. 2d 349 (S.D.N.Y. 2007) cited by Plaintiffs is inapplicable to the case at bar because it involved an audit engagement. But no accounting firm

was a defendant in the Fraternity Fund case, which is cited in Plaintiffs' brief (at pages 24-25), not on the issue of audit standards, but for the proposition that "allegations of 'willful blindness' or 'conscious avoidance' in a complaint are sufficient to avoid dismissal of an aiding and abetting claim on a motion to dismiss on the issue of adequately pleading the defendant's knowledge." GSP also asserts that Weinberg v. Mendelow, 113 A.D.3d 485, 979 N.Y.S.2d 29 (1st Dept. 2014) does not apply because the case involved an audit engagement and bookkeeping irregularities. However, the case does not state the nature of the defendant accounting firm's engagement by FGLS Equity, LLC, a Bernard Madoff feeder fund, but rather, addresses what the defendant accountant and accounting firm knew or could have known, an issue that applies in this case, too, as GSP's knowledge of Kenneth's actions and further knowledge that Ellen was unaware of them are significant to this case.

V. Plaintiffs Have Adequately Pled Their Claims Regarding the Citibank Loan and Guaranty

As is set forth in detail in Plaintiff's brief at pages 7-8 and in FAC ¶¶ 58-62, 64-66 (R. 128-129), Plaintiffs reasonably believe that the only way Kenneth could have provided or forwarded Ellen's financial documents to Citibank, which would have been required in order for Kenneth to obtain the Citibank loan that was supported by a guaranty on which Ellen's signature was forged, was from GSP. We submit that, at this stage of the pleadings, it was inappropriate to dismiss this claim

on a motion to dismiss, and thereby deny Plaintiffs discovery on the issue of where Kenneth obtained Ellen's financial documents.

VI. Plaintiffs Did Not Release GSP

Finally, Plaintiffs respectfully submit that contrary to GPS's arguments, there is nothing in the record that can support the argument that Plaintiffs ever released GSP from any liability whatsoever. Plaintiffs' brief at pages 29-32 explains in detail why the Diner's forgiving the "loans" that Kenneth took out did not affect Plaintiffs' claims against GSP.

For the purposes of this reply, we note that GSP incorrectly states at page 15 of its brief that Ellen's email notifying Kenneth that the Diner was going to forgive the "loans" "confirmed the desire to take advantage of a tax deduction vis-à-vis this release." This is patently untrue. The email does refer to tax issues, but only to state that the accountants are going to prepare "the required forms" to report the loan forgiveness to the IRS and to state that Ellen had been told that Kenneth had "tax attributes" that would "mitigate any tax impact the cancellation of debt may cause." (R. 222). In other words, Ellen was saying that she had been informed that, because Kenneth appeared to be insolvent, he likely would not be required to recognize taxable "forgiveness of debt" income on the entire amount forgiven.

Given the clear language of this email and that it does not contain any reference to the release or waiver of any claims (especially as it relates to GSP), it is

inexplicable how GSP can argue that Plaintiffs' citations to the general rules that apply in determining the existence, nature, and extent of a release or waiver are inapplicable in the context of a motion to dismiss under CPLR 3211(a). Certainly, the issue here is whether particular documents, that is, Ellen's email regarding the loans' being forgiven and related tax filings, effectively release GSP under applicable law. GSP has offered no basis in the record to support that conclusion and New York law makes clear that Ellen's email cannot constitute a release or waiver in favor of GSP.

CONCLUSION

For the foregoing reasons, and for the reasons set forth in Plaintiffs' original brief, Plaintiffs-Appellants respectfully request that the Court reverse the Order of the Motion court and remand this matter as against GSP on all causes of action asserted against it in the FAC.

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