

CERTIFIED FOR PARTIAL PUBLICATION*

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

DIVISION FIVE

TOM FRAME et al.,

Plaintiffs and Appellants,

v.

**PRICEWATERHOUSECOOPERS
LLP,**

Defendant and Respondent.

A106383

**(Alameda County
Super. Ct. No. 2002056106)**

Appellants Tom Frame, Bruce Miller, and Ronald G. VandenBerghe (for themselves and as representatives of a class) and Six Sigma LLC (by its trustee in bankruptcy), maintain the trial court erred in granting respondent PricewaterhouseCoopers LLP (PwC) summary judgment on claims based on theories of conspiracy, aiding and abetting, and third party beneficiary law.

In the published portion of our opinion, we conclude that a triable issue of material fact as to appellants' aiding and abetting claim precludes summary judgment, but that summary adjudication was properly granted with respect to appellants' conspiracy claim. In the unpublished portion of the opinion, we determine that appellants have no cause of action under a third party beneficiary theory as a matter of law. Because the court erred in regard to appellants' aiding and abetting claim, we reverse the judgment.

* Pursuant to California Rules of Court, rules 976(b) and 976.1, this opinion is certified for publication with the exception of part D.

I. FACTS AND PROCEDURAL HISTORY

A. FACTUAL SUMMARY

For background purposes, we summarize the relevant events according to the parties' statements of material facts and evidence in the trial court.

1. The Partnerships' Investments in PinnFund

Grafton Partners, LP (Grafton) and Allied Capital Partners (Allied) were limited partnerships. Certain individuals who invested in Grafton and Allied are referred to as appellant "Investors." Appellant Six Sigma LLC (Six Sigma) was formed after Grafton and Allied.

The general partner of Grafton and Allied, and the managing member of Six Sigma, was Peregrine Funding, Inc. (Peregrine). Peregrine was owned and managed by James Hillman.

Hillman created and promoted Grafton, Allied, and Six Sigma as vehicles for investing in loans issued by PinnFund USA, Inc. (PinnFund), a mortgage company owned and operated by Michael Fanghella. Pursuant to a Spot Loan Funding Agreement (SLFA), the funds provided to PinnFund were for the purpose of creating mortgages; when not so invested, the funds were to be held in a trust account with PinnFund as trustee. The SLFA also provided for annual audits of each Funding Entity (e.g., Grafton and Allied) and entitled each Funding Entity access to PinnFund's audited financial statements.

As it turned out, Fanghella was misappropriating the money invested in PinnFund. Appellants contend that Peregrine/Hillman, who had known Fanghella for 20 years and directed the limited partnerships' investments into PinnFund, were participants in the PinnFund/Fanghella fraudulent scheme.

2. Peregrine Hires PwC To Audit Grafton and Allied (March 1999)

In March 1999, Peregrine/Hillman hired PwC to audit the financial statements of Grafton and Allied for the year ended December 31, 1998. The audit engagement letter, dated March 11, 1999, was addressed to Peregrine's Chief Financial Officer, Peter Kodzis. It read in part: "The purpose of this letter is to confirm our understanding of the

terms of our engagement as independent accountants of Grafton Partners and Allied Capital Partners (the ‘Partnerships’). [¶] Services and related reports [¶] We will audit each Partnership’s balance sheet at December 31, 1998, and the statements of operations, changes in partners’ capital and cash flows for the year ended December 31, 1998. Upon completion of our audits, *we will provide you with our audit reports* on the financial statements referred to above. If for any reason we are unable to complete the audits, *we may decline to issue reports* as a result of this engagement. [¶] . . . [¶] . . . [W]e cannot ensure that errors, fraud or other illegal acts, if present, will be detected. However, *we will communicate to you*, as appropriate, any illegal act, material errors, or *evidence that fraud may exist* as identified during our audits.”¹ (Italics added.) In addition, the letter advised: “Our audits are *intended for the benefit of the Partnerships*. The audits will not be planned or conducted in contemplation of reliance by any third party or with respect to any specific transaction.” (Italics added.)

3. Appellant Six Sigma is Formed (March 1999)

Six Sigma was established in March 1999. As mentioned, like Grafton and Allied, Six Sigma invested funds with PinnFund at Peregrine/Hillman’s direction. Unlike Grafton and Allied, Six Sigma was not mentioned in the PwC engagement letter.

4. PwC’s Audit of Grafton and Allied (June 1999)

During the audits of Grafton and Allied, PwC became aware that the partnerships’ only significant assets were funds they had loaned to PinnFund. If PinnFund could not repay those loans, Grafton and Allied had little value. So PwC asked Peregrine/Hillman, who had arranged for the audits, for PinnFund’s audited financial statements in order to determine if the Grafton and Allied funds were recoverable.

Hillman told PwC that the PinnFund audited financial statements had not been completed. PwC soon learned, however, that regulations required the filing of this information with the United States Department of Housing and Urban Development

¹ As discussed *post*, although the letter was addressed to general partner Peregrine, appellants contend that the word “you” actually referred to the limited partnerships and, under the circumstances, should be read to include the limited partner Investors.

(HUD) by March 31, 1999. PwC so informed Peregrine's Hillman and Kodzis, believing the matter was "fishy" or, at least, Peregrine was not trying hard enough to obtain PinnFunds' financial statements.

Eventually, Peregrine/Hillman and PinnFund delivered to PwC multiple sets of purported PinnFund audited financials. Each of these sets, however, turned out to be a forgery.

PwC received the first purported copy of PinnFund's final audited financial statements from Peregrine on June 1, 1999, along with a signed audit report bearing the name of the accounting firm of Levitz, Zacks & Ciceric (Levitz). But when PwC auditor Todd Goldman spoke with Levitz's Kim Ufford to verify the accuracy of the financial statements, PwC discovered important differences between the financial statements it received from Peregrine and the financial statements Levitz had actually issued.

By June 4, 1999, PwC orally and in writing advised Peregrine, as Grafton and Allied's general partner, that the purported financial statements Peregrine had sent to PwC were not issued by Levitz. PwC requested that Levitz send the audited financial statements directly to PwC.

Instead, on June 7 and 8, 1999, PwC received two slightly different sets of purported final PinnFund financial statements, one from Peregrine (which Peregrine had received from PinnFund) and the other from PinnFund directly. When PwC's Goldman again spoke with Levitz's Ufford, he determined that these financial statements were bogus as well. Not surprisingly, PwC had concerns about the authenticity of the PinnFund financial statements. It also realized that Hillman had falsely represented, for nearly two months, that the PinnFund audit reports had not been completed.

5. PwC's Options to Hillman (Conversation of June 22, 1999)

On June 22, 1999, PwC partner David Chrencik and PwC audit manager Goldman discussed the status of the audits with Hillman by telephone. An internal PwC e-mail authored by Chrencik, and dated June 22, 1999, purported to summarize the conversation.

According to the e-mail, Chrencik told Hillman that PwC could not issue reports on Grafton and Allied without resolving the issue of the inconsistent PinnFund audit

reports. Chrencik informed Hillman that PwC had three reporting options under the circumstances: “(1) Resolve the PinnFund audit report issue and we could issue our reports on the financial statements. [¶] (2) If the report issue is not resolved, we could issue a disclaimer of opinion. [¶] (3) If the report issue is not resolved, we could issue no report.”

Hillman requested that PwC issue a more limited report on the partnerships, without regard to what PinnFund was doing with the funds advanced by the partnerships. Chrencik declined. In addition, the e-mail recounted, Chrencik advised Hillman “twice during the conversation that, he, as management of Grafton and Allied, should be more concerned than us over the audit report inconsistencies and the apparent inability or unwillingness to resolve this, and that this situation indicated that the possibility of fraud (and I used the word ‘fraud’) may exist or that the amounts advanced to PinnFund may not be recoverable.” When Chrencik told Hillman he was considering communicating his concerns to Hillman in writing, Hillman requested he not do so. Hillman asked that PwC return all of the Grafton and Allied documents in PwC’s possession—which PwC agreed to do—and told PwC he was terminating the auditor-client relationship.

According to Goldman’s deposition testimony, Hillman indicated that he was not concerned about the discrepancies in the PinnFund financial statements, because he had known Fanghella for 20 years, the mortgages issued with the partnerships’ funds were secured, and he was therefore not looking to PinnFund’s own financial capabilities to repay the amounts due to the partnerships.

With the audit engagement terminated, PwC never issued audit reports for the partnerships or a disclaimer of opinion. And, although PwC indicated its suspicion of fraud to Peregrine/Hillman—as the partnerships’ general partner—it did not communicate the suspected fraud to the Investors (limited partners) of Grafton and Allied or to Six Sigma. Appellants point out that PwC had the names and addresses of the Grafton and Allied Investors and knew that the law firm of Sheppard, Mullin, Richter, & Hampton was counsel for the partnerships, but did not contact them. As the central issue

in this appeal, the parties debate whether disclosure to Peregrine/Hillman was sufficient, in light of the appearance that Peregrine/Hillman may have been involved in the fraud.

6. Hillman's July 6, 1999 Letter

On July 6, 1999, Hillman wrote to PwC: "Reference is made to our last telephone conversation of Tuesday, June 22, 1999, during which Dave [Chrencik] advised me that he would not authorize release of the completed Allied and Grafton audits without additional information being supplied by PinnFund, USA. As I explained to both of you, I have no control over PinnFund[,] and[] they are not the subject of the audit or your firm's engagement. Dave thereafter asked me to terminate your firm. [¶] Please be advised that I welcome receipt of the two audits. . . . I would prefer not to have to do this all over again with another firm. If I do not receive both audits by July 14, 1999, I shall proceed to engage another accounting firm." PwC did not respond to the letter.

7. Another Auditor Issues Clean Audit Reports

Peregrine/Hillman retained another auditing firm, RINA Accountancy Corporation (RINA), to perform the audits of the partnerships. RINA issued clean audit opinions based on the Grafton and Allied financial statements.

Meanwhile, Peregrine did not pay PwC for its services in June and July. Eventually, PwC was paid \$11,700, about half of what Peregrine owed.

8. Levitz Discloses the Inconsistent PinnFund Financials (September 1999)

Levitz, who had learned from PwC of the false PinnFund financial statements in June 1999, was required by auditing standards and regulations to disclose the matter to HUD as the appropriate governmental authority. (See GAAS [Generally Accepted Auditing Standards], § 316.40(a).) Levitz wrote to HUD three months later. In a letter dated September 8, 1999, counsel for Levitz informed HUD: "Levitz, Zacks & Ciceric Accountants, Inc. personnel determined that the PinnFund, USA financial statements in the possession of PRICEWATERHOUSECOOPERS were in fact materially different from the December 31, 1998 financial statements as audited by Levitz, Zacks & Ciceric Accountants, Inc. The purported audit report attached to such financial statements was not the audit report issued by Levitz, Zacks & Ciceric Accountants, Inc."

9. PinnFund Is Shut Down

Fanghella's wrongdoing was eventually discovered by the Securities Exchange Commission (SEC). In March 2001, the SEC shut PinnFund down and sued PinnFund, Fanghella, Hillman, and others in federal court.

10. Testimony of PwC's Chrencik Before the SEC

During its pre-filing investigation, the SEC took the deposition of PwC's Chrencik on March 16, 2001. According to Chrencik, he did not recall learning that none of the financial statements PwC had received was genuine. As discussed *post*, the parties debate the veracity and significance of this testimony.

B. THE LITIGATION AGAINST PWC

Grafton, Allied, Six Sigma, and individuals on behalf of themselves and other investors sued PwC and others on numerous theories, including breach of contract, professional negligence, fraudulent concealment, aiding and abetting fraud, conspiracy to defraud, aiding and abetting the general partner's breach of fiduciary duty, and conspiracy to breach that fiduciary duty. The court certified a class of all persons (the Investors) who held limited partnership interests in Grafton or Allied in the period from March 11, 1999, to March 21, 2001. As relevant here, it was essentially asserted that PwC should have gone beyond Grafton and Allied's general partner—Peregrine—and reported directly to the investors what it knew.²

1. Jury Trial Issue and Prior Appeal

The trial court struck the partnerships' request for a jury trial, based on a jury trial waiver contained in the engagement letter. In appeal number A102790, we issued a peremptory writ of mandate, holding that Grafton's and Allied's predispute waiver of the right to a jury trial was unenforceable. The California Supreme Court affirmed the decision. (*Grafton Partners v. Superior Court* (2005) 36 Cal.4th 944.)

² RINA and Levitz were also sued. Settlements with them were approved by the court on April 2003 and October or November 2003, respectively.

2. PwC's Motions for Summary Judgment and Summary Adjudication

In December 2003, PwC moved for summary judgment or, alternatively, summary adjudication, contending it was entitled to judgment against Grafton, Allied, Six Sigma, and the Investors as a matter of law. As to the claims of Six Sigma and the Investors, PwC maintained it had acted in accord with its profession's Generally Accepted Auditing Standards (GAAS), PwC owed appellants no duty of disclosure, there was no triable issue as to whether it aided and abetted the alleged fraud or formed and participated in a conspiracy to defraud, and appellants were not entitled to recovery as third party beneficiaries of the engagement letter between Peregrine and PwC. Appellants' evidence included expert witness testimony to the effect that PwC had a duty to go beyond the general partner (Peregrine) and report what it knew directly to the Investors. Appellants also contended the Investors were third party beneficiaries of obligations PwC undertook in the engagement letter.

On March 23 and 29, 2004, the trial court announced its rulings.³ The court granted PwC summary judgment as to the claims of Six Sigma and the Investors, ruling that PwC owed no contractual or fiduciary duty to Six Sigma, and the Investors were neither PwC's client nor a third party beneficiary of the engagement letter and PwC had no duty to communicate with them.⁴

Judgment against Six Sigma and the Investors was entered on April 13, 2004. This appeal followed.

³ Also on March 23, 2004, the court granted appellants' motion to file a fourth amended complaint, adding causes of action for PwC's participation in Hillman's and PinnFund's breach of fiduciary duty and for PwC's "intentional collaboration" (conspiracy and aiding and abetting) in Hillman's and PinnFund's actual fraud against all plaintiffs including Six Sigma, with the understanding that the fate of these additional claims would be addressed in the pending motions for summary judgment.

⁴ With respect to Grafton and Allied, the court denied PwC's motions for summary adjudication, except as to the cause of action for conspiracy to breach, and aiding and abetting a breach, of fiduciary duty. The trial of Grafton's and Allied's claims against PwC was continued until resolution of the jury trial waiver issue by the California Supreme Court.

II. DISCUSSION

Six Sigma and the Investors appeal the dismissal of their claims for aiding and abetting fraud and conspiracy to commit fraud. In addition, the Investors appeal from dismissal of their third-party beneficiary claims for negligence and breach of contract.

A. STANDARD OF REVIEW ON SUMMARY JUDGMENT

Central to appellants' argument is that the trial court reached an improper decision in light of its factual findings.⁵ In our review of the grant of summary judgment, however, we conduct an independent review to determine whether there are triable issues of material fact and the moving party is entitled to judgment as a matter of law. (Code Civ. Proc., § 437c, subd. (c); *Buss v. Superior Court* (1997) 16 Cal.4th 35, 60; *Ochoa v.*

⁵ Appellants refer us to the following material facts and inferences on which the trial court relied, among others, in reaching its decision: (1) a two-month delay in PwC's receiving the PinnFund audit reports from Hillman could lead the trier of fact to infer that Hillman was delaying and PwC knew Hillman was delaying; (2) PwC auditor Goldman learned that the copy of a 1997-1998 PinnFund audit report, which it received from Peregrine/Hillman, was different than the audit issued by Levitz, from which the trier of fact could reasonably conclude that at this time (June 1999) PwC suspected fraud at PinnFund; (3) PwC was told that all three purported PinnFund audits it received were different than the audit actually issued, from which the trier of fact could reasonably conclude PwC knew at this time there was fraud at PinnFund; (4) Hillman's lack of shock or concern at the multiple versions of the PinnFund audit report could lead the trier of fact to infer that Hillman knew of the fraud at PinnFund and was a participant in that fraud; (5) the trier of fact could reasonably infer that PwC knew that Hillman would not inform the Investors of a fraud at PinnFund, and PwC struck a deal with Hillman that it would return its documents and not expose the fraud in exchange for being paid for its work; (6) the trier of fact could reasonably infer that "PwC knew that unless PwC provided effective notice that would stop the fraud, Hillman would continue to solicit money that would be invested in PinnFund where it would be subject to some form of fraud or misappropriation"; (7) "PwC also knew that Hillman intended to solicit more investors for more money"; (8) PwC never investigated why it got three versions of the 1997-1998 audit report, should have expected to be contacted by a successor auditor to determine why it did not issue an audit report, but never was; (9) "PwC lost the stack of workpapers related to its efforts to audit the Funding Entities"; (10) "As stated in the Order of March 23, 2004, a reasonable jury might find that Hillman was engaged in fraud, that PwC discerned that Hillman was engaged in fraud, that PwC knew that Hillman intended to defraud more persons through Six Sigma, and that PwC knew that its communications to Hillman on June 22, 1999, were ineffective to stop the fraud."

Pacific Gas & Electric Co. (1998) 61 Cal.App.4th 1480, 1485.) We construe the moving party's evidence strictly, and the nonmoving party's evidence liberally, in determining whether there is a triable issue. (See *D'Amico v. Board of Medical Examiners* (1974) 11 Cal.3d 1, 20; *Alex R. Thomas & Co. v. Mutual Service Casualty Ins. Co.* (2002) 98 Cal.App.4th 66, 72 (*Thomas*).

A defendant seeking summary judgment must show that at least one element of the plaintiff's cause of action cannot be established, or that there is a complete defense to the cause of action. (Code Civ. Proc., § 437c, subd. (p)(2).) The burden then shifts to the plaintiff to show there is a triable issue of material fact on that issue. (See Code Civ. Proc., § 437c, subd. (p)(2); *Thomas, supra*, 98 Cal.App.4th at p. 72.)

B. AIDING AND ABETTING HILLMAN'S AND PINNFUND'S ACTUAL FRAUD

Liability for aiding and abetting an intentional tort may arise if the defendant "(a) *knows* the other's conduct constitutes a breach of duty and gives *substantial assistance* or encouragement to the other to so act **or** (b) gives *substantial assistance* to the other in accomplishing a tortious result and the person's own conduct, separately considered, constitutes a *breach of duty* to the third person. [Citations.]" (*Saunders v. Superior Court* (1994) 27 Cal.App.4th 832, 846, italics and boldface added (*Saunders*); see *Casey v. United States Bank Nat. Assn.* (2005) 127 Cal.App.4th 1138 (*Casey*); *Fiol v. Doellstedt* (1996) 50 Cal.App.4th 1318, 1325-1326 (*Fiol*).

The parties to this appeal do not dispute the sufficiency of the evidence (for purposes of raising a triable factual issue) as to whether PwC *knew* of some fraud of Peregrine/Hillman and PinnFund. Both Peregrine and PinnFund had delivered bogus financial statements. PwC's Goldman conceded the significance of this discovery in his deposition: "Q. What other thing could falsified financial statements be than crookedness? [¶] A. I will grant you that." Furthermore, Hillman had initially told PwC that the PinnFund financial statements were unavailable—a proposition that was false and led PwC to suspect something "fishy." And when confronted with the discrepancies between the various sets of PinnFund statements, Hillman appeared unconcerned, urged nondisclosure of the fraud, and yet intended to continue directing investments to

PinnFund. As the trial court observed: “PwC also knew that Hillman intended to solicit more investors for more money. . . . The trier of fact could reasonably infer that PwC knew that unless PwC provided effective notice that would stop the fraud, Hillman would continue to solicit money that would be invested in PinnFund where it would be subject to some form of fraud or misappropriation.” (Italics omitted.) Thus, based on the record before us, as well as the parties’ omission of any significant debate on the point, we proceed with the understanding that there is at least a triable issue as to the existence and extent of PwC’s actual knowledge of Peregrine’s and PinnFund’s fraud. (See *Casey*, *supra*, 127 Cal.App.4th at p. 1145 [aiding and abetting liability requires actual knowledge of the specific primary wrong the defendant substantially assisted].)

The question, therefore, is whether there was sufficient evidence that PwC provided *substantial assistance* to the fraud with this knowledge.⁶

Appellants contend PwC substantially assisted the fraudulent scheme by making certain agreements with Peregrine/Hillman to conceal the fraud. As the trial court described it, a trier of fact could reasonably conclude “PwC struck a deal with Hillman that PwC would return its documents and not expose the fraud in exchange for being paid for its work.” Similarly, appellants claim, PwC agreed to return its file to Peregrine/Hillman and not disclose its findings of fraud or prepare a written audit report. However, these mere *agreements*—in and of themselves—did not provide substantial assistance to the purported fraudulent scheme. We must examine what PwC actually *did* pursuant to those agreements.

⁶ We need not consider, for aiding and abetting purposes, whether PwC owed appellants an independent duty to disclose the fraud, in light of the evidence that it *knew* of fraud perpetrated by Peregrine/Hillman. Unlike civil conspiracy liability, a party need not owe any duty, let alone the same duty, to be subject to liability for aiding and abetting another’s breach. (*Casey*, *supra*, 127 Cal.App.4th at p. 1145, fn. 2 [bank could be liable for aiding and abetting breach of fiduciary duty to a company, even though it had no fiduciary duty of its own to the company]; *Neilson v. Union Bank of California, N.A.* (C.D.Cal. 2003) 290 F.Supp.2d 1101, 1133 [“No California case . . . holds that a party must owe the plaintiff a duty before he or she can be held liable as an aider and abettor.”].)

In this regard, appellants argue: (1) PwC returned to Hillman certain documents reflecting the fraud; (2) PwC destroyed its workpapers; (3) PwC wrote an internal e-mail that did not discuss the details of the fraud; (4) PwC partner Chrencik committed perjury in a SEC hearing; and (5) PwC agreed not to write, and did not write, an audit report that would have disclosed the fraud. For reasons we shall explain, the first four items, viewed independently, are insufficient to demonstrate a triable issue of material fact. But combined with the fifth item—the absence of audit reports (or other disclosure of the fraud)—a reasonable trier of fact *could* conclude that PwC provided substantial assistance to the fraud in which Peregrine/Hillman and PinnFund/Fanghella were allegedly involved.

Returning documents. Although the trial court found that a trier of fact could conclude “PwC struck a deal with Hillman that PwC *would* return its documents,” PwC insists there is no evidence that any documents were actually returned to Hillman. Furthermore, the agreement to return documents pertained to those provided to PwC by *Grafton and Allied*—not the auditing workpapers and documents of PwC—and PwC retained the falsified PinnFund financial statements. In any event, even if the PwC “files” were given to Hillman as appellants claim, appellants do not satisfactorily explain how returning those documents—including the partnership offering memorandum, bank statements, partner’s files and correspondence—actually aided in the fraud or its concealment.

Missing workpapers. The parties sharply dispute the evidence on this point. From the fray we gather that the subject documents were not PwC’s internal *electronic* workpapers, which contain auditor notes and audit programs and comprise contemporaneous records of PwC’s audit work: PwC retained these documents and produced them in discovery during the litigation. PwC also produced Chrencik’s desk file, which contained the altered PinnFund financial statements PwC had received. Instead, the subject documents were PwC’s *external* workpapers, which included hard copies of audit confirmations and the engagement letter. Appellants speculate that these documents might have mentioned the forgeries or hinted at partnership losses. They

further insist that a trier of fact could conclude the documents were intentionally destroyed by PwC, despite evidence that they were simply misplaced in the course of an employee's departure from PwC.⁷ But whether the documents were lost, hidden, or destroyed, there is insufficient evidence that their disappearance provided substantial assistance to the fraud or its concealment.

Chrencik's Alleged Perjury. Chrencik, a partner in PwC, testified at a SEC hearing that he knew about the inconsistencies between the purported PinnFund financial statements, but did not recall learning the financial statements were not authentic. Appellants contend this was a lie, because PwC partner Goldman testified that he had briefed Chrencik about the fraudulent audit reports. Also, appellants contend, while Chrencik denied before the SEC that he was told by PinnFund's auditor (Levitz) of the lack of authenticity, he later admitted in deposition in this litigation there were conversations between PwC and Levitz on this point. In rebuttal, PwC attempts to harmonize Chrencik's testimony: he told the SEC that he knew about the inconsistencies between the different sets of PinnFund financial statements, but he was not a party to all of the conversations with Levitz regarding the PinnFund financial statements and did not recall, either way, learning that *none* of the financial statements that PwC had received were genuine.

After examining the testimony to which the parties refer us, including Chrencik's assertions before the SEC that his recollection was not keen and the indication in his deposition that his memory had subsequently been refreshed, we believe appellants' aspersions of perjury are unfounded. But even if a trier of fact might conclude that

⁷ The trial court, in its summary judgment ruling, determined that "PwC *lost* the stack of workpapers related to its efforts to audit the Funding Entities." (Italics added.) Appellants note the court had earlier observed, in the context of a discovery order, that the "disparity, if any, between what happened to the workpapers and what should have happened to the workpapers is relevant to the strength of any inference that might be drawn from PwC's inability to locate the documents." While this may have justified the requested discovery, the court subsequently concluded on the basis of the actual evidence that PwC "lost," and inferentially did not intentionally cause, the workpapers' disappearance.

Chrencik intentionally gave false testimony to the SEC about his knowledge of the fraud, appellants do not demonstrate how such perjury would have helped to *conceal or further* the fraud, which had already been detected by the SEC. *If* there were perjury, the circumstances suggest it was for the purpose of minimizing PwC’s liability, not assisting the fraud.

E-mail. Appellants also argue that PwC provided substantial assistance by writing the internal e-mail purporting to summarize the call with Hillman, without mentioning the forged audit reports and other details. Again, this does not demonstrate substantial assistance of the purported fraudulent scheme: while the e-mail might be consistent with the conclusion that PwC was legitimizing its own actions, appellants do not demonstrate how an e-mail mentioning a suspicion of “fraud” would help conceal the fraud.

No Audit Report or Disclosure to Investors. The fact that PwC did not issue an audit report might be evidence from which a reasonable trier of fact could conclude PwC provided substantial assistance to the fraud. Such a report would have described the forged financial statements and the absence of any verification of the continued existence of claimed partnership assets, and it would have been available to the Investors. (See Corp. Code, § 15634, subs. (b)(1), (c)(3).) The absence of a written audit report—or any other disclosure of the fraud to the limited partner Investors—assisted Peregrine/Hillman and PinnFund in their purported fraudulent scheme by postponing public detection of the fraud and giving them time to solicit and obtain additional investments. This assistance, extended under circumstances in which PwC agreed to return documents to Hillman and misplaced or destroyed other documents, could lead a trier of fact to conclude that PwC provided substantial assistance to Peregrine/Hillman with knowledge of the fraud.

PwC’s arguments to the contrary may be divided into three overlapping contentions: (1) PwC’s conduct was merely inaction; (2) not issuing an audit report was consistent with GAAS accounting standards; and (3) under GAAS, PwC had no duty to disclose the fraud to the limited partners. We find these arguments unavailing.

1. Inaction

PwC contends (as the trial court concluded) that the decision not to issue an audit report or disclaimer opinion, or to otherwise disclose the facts of fraud to the limited partners, was mere inaction on which aiding and abetting liability cannot be based. (See *Fiol, supra*, 50 Cal.App.4th at p. 1331 [“A supervisor does not aid and abet a harasser by mere inaction.”].)⁸ We do not agree.

In *Fiol*, the plaintiff employee had informed a supervisor that she was being sexually harassed by another employee. (*Fiol, supra*, 50 Cal.App.4th at p. 1322.) The supervisor nevertheless failed to control, monitor, discipline, or restrain the offending employee. (*Id.* at pp. 1322-1323.) *Fiol* sued the supervisor, among others, alleging inter alia that he aided and abetted a violation of the sexual harassment provisions of the Fair Employment and Housing Act (FEHA). (*Id.* at pp. 1323-1325; see Gov. Code, §§ 12921, 12940, subd. (j)(1) [formerly § 12940, subd (h)(1)].) The court granted the supervisor’s motion for judgment on the pleadings, concluding that a supervisor could not be personally liable under the FEHA, as an aider and abettor of the harasser (or the employer), for failing to prevent sexual harassment. (*Fiol, supra*, at p. 1326.) The court reasoned that mere inaction did not constitute substantial assistance and a supervisory employee owed no duty to his or her subordinates to prevent sexual harassment in the workplace. (*Ibid.*)

The matter before us is markedly different. In the first place, although the supervisor’s failure to restrain *Fiol*’s harasser may have contributed to the continuation of the harassment in the sense that he still had access to her, it did not actually *assist* the harasser in groping and fondling her. Here, by contrast, declining to pull the cover off of a clandestine fraud *did* enable the wrongdoers to perpetrate the fraud—maintaining the secrecy that was critical to their fraudulent scheme. Indeed, while the victim in *Fiol* was

⁸ The trial court ruled there was no evidence that PwC made an affirmative misrepresentation or misleading disclosure, and because PwC had no duty of disclosure (or other duty) to Six Sigma or the Investors, its failure to disclose the purported fraud was mere inaction and thus insufficient for aider and abettor liability.

obviously aware of her harasser's wrongdoing, the victims of the fraud in the matter before us were not, having been kept in the dark in part because of PwC's silence.

Moreover, there is no indication in *Fiol* that the supervisor was hired for the explicit purpose of restraining sexual harassers. Here, by contrast, the very reason for PwC's retention was to detect and disclose improprieties such as fraud. While there is a *factual* dispute as to *who* PwC should have reported the fraud *to* (the general partner or the limited partners), there is no question that PwC had a duty to disclose the fraud to somebody (on behalf of the partnerships). Appellants' aiding and abetting claim is not precluded, as a matter of law, by *Fiol*.

2. GAAS and the No Report Option

Next, PwC argues that the option of not preparing an audit report cannot constitute aiding and abetting, because it was consistent with the audit engagement letter and GAAS accounting standards. Again, we must disagree. Even if an act (or inaction) is lawful in itself and consistent with regulatory standards, it can still, as a factual matter, substantially assist another party's perpetration of an intentional tort. (See *Casey, supra*, 127 Cal.App.4th at p. 1145 ["common sense tells us that even 'ordinary business transactions' a bank performs for a customer can satisfy the substantial assistance element" if known to assist the customer's tort].)

Furthermore, while the engagement letter and GAAS by their terms may have *permitted* PwC not to issue an audit report or disclaimer of opinion (or otherwise disclose the purported fraud), they did not *compel* PwC to maintain its silence. As to the engagement letter, the pertinent passage read: "If for any reason we are unable to complete the audits, we *may* decline to issue reports as a result of this engagement." (Italics added.) From this provision, we conclude that declining to issue a report did not breach PwC's engagement contract; but the provision did not contractually bar PwC from issuing a report or disclosing the fraud to others. Similarly, at least as far as the record we review, GAAS did not bar PwC from issuing an audit report or disclaimer of opinion. GAAS *permits* auditors to issue adverse opinions or disclaimers of opinion in the event of a material illegal act. (See GAAS, § 317.18 ["If the auditor concludes that an illegal act

has a material effect on the financial statements, and the act has not been properly accounted for or disclosed, the auditor should express a qualified opinion or an adverse opinion”]; § 317.19 [“If the auditor is precluded by the client from obtaining sufficient competent evidential matter to evaluate whether an illegal act . . . occurred, the auditor generally should disclaim an opinion on the financial statements.”].) If, as alleged here, the client refuses to accept such opinions, GAAS provides that “the auditor should withdraw from the engagement and indicate the reasons for withdrawal in writing to the audit committee or board of directors.” (GAAS, § 317.20.) Because the partnerships had no audit committee or board of directors, the question arises how GAAS section 317.20 should be applied to the matter before us. As framed by the parties, this is a factual question, and the evidence is insufficient to resolve it as a matter of law.

3. GAAS and the Duty to Disclose to Investors

In a similar vein, PwC contends that its failure to disclose the fraud to Investors cannot constitute substantial assistance, because PwC had no duty to make such a disclosure. As mentioned, an independent duty is not required for aiding and abetting liability (see fn. 6, *ante*). Nonetheless, because appellants alleged that PwC provided substantial assistance by failing to disclose information, whether appellants have produced evidence to demonstrate substantial assistance logically depends in part on whether PwC had any *obligation* (whether or not in the form of an independent legal duty) to make such a disclosure.

On this point, there is a factual question whether the standard of care that PwC owed to Grafton and Allied required PwC to go beyond general partner Peregrine/Hillman and disclose the fraud to the limited partner Investors, in light of Peregrine/Hillman’s ostensible complicity in the fraud.

PwC had reason to believe—and did believe—that Hillman, as part of the fraudulent scheme, had no intention of telling the limited partners about the forgeries and fraud. Goldman testified in deposition: “Q. When he [Hillman] made this statement that not--don’t put it in writing, didn’t you have the feeling he wasn’t going to tell anybody

about what had been told to him verbally concerning fraud and possible loss? [¶] A. Yes, I agree with that.”

According to appellants’ expert witness testimony, Peregrine’s apparent involvement in the fraud obligated PwC to notify the limited partners, directly or through partnership counsel. The expert witnesses explained that, where the auditor is engaged by a limited partnership, the “client” includes the general partner and the limited partners, and where “the general partner was committing the fraud, then certainly the limited partners should have been notified that the fraud existed.” (See also Corp. Code, § 16102, subd. (f) [as to general partnerships, notice to partner of fraud in which the general partner is himself engaged is not legal notice to the partners or the partnership]; Corp. Code, § 15722 [“In any case not provided for in this chapter, limited partnerships shall be governed in the same manner as general partnerships would be governed . . . by . . . the Uniform Partnership Act of 1994 (Chapter 5 (commencing with Section 16100)).”].) PwC knew the names and addresses of the limited partner Investors and the partnerships’ attorneys, but did not contact them.

PwC maintains it had no obligation to disclose the fraud to the limited partners, because declining to report to the limited partners was consistent with GAAS. Under GAAS, PwC asserts, an auditor is required to report evidence of fraud or illegality only to senior management, the audit committee, or others with equivalent authority and responsibility. (GAAS, §§ 316.38, 317.17.) If the highest level of management is involved in the fraud, the auditor must report to the audit committee. (*Ibid.*) In the absence of an audit committee or others with equivalent oversight authority, the auditor may withdraw from the engagement under GAAS sections 316.36 and 316.40. Grafton and Allied had no audit committee, board of directors, board of trustees or equivalent body, and because the limited partners never organized oversight committees, PwC argues, the only party to whom PwC could report was general partner Peregrine. Furthermore, PwC insists, an auditor is ordinarily *precluded* from disclosing confidential client information to nonclients, such as the Grafton and Allied Investors. (GAAS, § 316.40 [“[t]he disclosure of possible fraud to parties other than the client’s senior

management and its audit committee ordinarily is not part of the auditor’s responsibility and ordinarily would be precluded by the auditor’s ethical or legal obligations of confidentiality unless the matter is reflected in the auditor’s report”].)

The issue, in this context, is therefore the standard of care—a *factual* matter.⁹ As a regulatory standard, GAAS is relevant to PwC’s standard of care, but it is not conclusive. Further, the application of the GAAS provisions to the matter before us is a matter of some debate, since the GAAS sections cited by PwC do not refer specifically to *limited partnerships*—whose owners have the right to receive copies of financial statements and auditor’s reports, the right to inspect the partnership’s books and records, and the power to remove the general partner. (Corp. Code, § 15636, subd. (f)(2).)

Appellants’ experts—relying not only on GAAS, but also on PwC’s internal guidelines, the internal guidelines of Coopers & Lybrand, and accounting publications—opined that the limited partners should have been notified of the fraud *notwithstanding* the GAAS provisions on which PwC relied. Under GAAS, they explained, PwC had a responsibility to report the fraud one level above those who were involved. Absent a formally appointed audit committee, that higher level of oversight was the limited partners, directly or through partnership counsel. Further, according to appellants’ experts, ethics standards do not preclude auditors from informing the limited partners of the general partner’s fraud: the attorneys for Grafton and Allied were not “outside” the partnerships for purposes of confidentiality restrictions, and it is unnecessary to obtain management’s consent to report the management’s fraud to the shareholders’ counsel. Thus, appellants produced evidence creating a triable issue of material fact.

⁹ PwC asserted in the trial court that “it had a legal duty to . . . Allied and Grafton” and that the relevant issue was “whether, under the relevant professional standards (*i.e.* the standard of care), PwC had an obligation to go beyond the general partner and report directly to the limited partner Investors in order to satisfy its duty of disclosure to it[s] clients, the Partnerships.” (Underscoring and italics in original.) Thus, it appears the parties did not frame the only issue as whether PwC had a legal duty to the limited partners, but whether, in satisfying its legal duty to the partnerships, the applicable standard of care required PwC to disclose the fraud to the limited partners.

PwC claims that California Code of Regulations, title 16, section 54.1, which prohibits an auditor from disclosing “confidential information . . . concerning a client . . . without the written permission of the client” prohibited PwC from disclosing Peregrine/Hillman’s and PinnFund’s fraud to the limited partners. Even assuming the “client” was Peregrine/Hillman, however, PwC provides no authority that the fraudulent *PinnFund* financial statements would be “confidential information . . . concerning a client” within the ambit of California Code of Regulations, title 16, section 54.1.

In the final analysis, it cannot be said—*as a matter of law* based on the record we review—that PwC did not provide substantial assistance by failing to disclose the fraud to the limited partners. Accordingly, there was a triable issue as to whether PwC provided substantial assistance to the fraud of Peregrine/Hillman and PinnFund.

As an aider and abettor, PwC would be jointly and severally liable to the victims of the fraud, which allegedly include Six Sigma and the Investors. (See *Pasadena Unified Sch. Dist. v. Pasadena Federation of Teachers* (1977) 72 Cal.App.3d 100, 113.)¹⁰ The court erred in granting summary adjudication on the cause of action based on aiding and abetting liability.

C. CONSPIRACY TO COMMIT FRAUD

“Conspiracy is not a cause of action, but a legal doctrine that imposes liability on persons who, although not actually committing a tort themselves, share with the

¹⁰ We do not conclude that PwC will necessarily be liable for all losses suffered as a result of the PinnFund/Fanghella fraudulent scheme even if PwC is found to have aided and abetted Peregrine/Hillman’s fraud. The evidence indicates a factual dispute as to the extent of PwC’s actual knowledge (e.g., Peregrine/Hillman’s fraudulent nondisclosure to investors, or some broader fraud of PinnFund), the *particular* fraud PwC’s acts and omissions assisted, and whether its assistance was substantial (considering, among other things, its disclosure to Levitz). There also appears to be a dispute as to the extent to which Peregrine/Hillman was involved in the PinnFund/Fanghella fraudulent scheme, and whether Peregrine/Hillman’s concealment was part of the broader scheme or perpetrated independently. PwC’s liability, if any, for aiding and abetting only a distinct fraud perpetrated by Peregrine/Hillman *could* be less than liability for aiding and abetting the broader fraudulent plan. But the record on appeal does not permit us to consider the matter further, and we leave the resolution of the factual issues to the trier of fact.

immediate tortfeasors a common plan or design in its perpetration. [Citation.] By participation in a civil conspiracy, a coconspirator effectively adopts as his or her own the torts of other coconspirators within the ambit of the conspiracy. [Citation.] In this way, a coconspirator incurs tort liability co-equal with the immediate tortfeasors.” (*Applied Equipment Corp. v. Litton Saudi Arabia Ltd.* (1994) 7 Cal.4th 503, 510-511 (*Applied Equipment*)).) Thus, ““the major significance of the conspiracy lies in the fact that it renders each participant in the wrongful act responsible as a joint tortfeasor for all damages ensuing from the wrong, irrespective of whether or not he was a direct actor and regardless of the degree of his activity.”” (*Id.* at p. 511.) As an example of the application of conspiracy theory, where no single defendant has committed all of the elements of a tort, but together all elements have been committed by codefendants possessing a common motive, all of the codefendants may be jointly liable for damages caused by the resulting tort.

To establish a civil conspiracy, the plaintiff must show: (1) the formation and operation of a conspiracy; (2) wrongful conduct in furtherance of the conspiracy; and (3) damages arising from the wrongful conduct. (*Applied Equipment, supra*, 7 Cal.4th at p. 511; *Kidron v. Movie Acquisition Corp.* (1995) 40 Cal.App.4th 1571, 1581 (*Kidron*)). The conspiring defendants must have actual knowledge that a tort is planned, concur in the tortious scheme with knowledge of its unlawful purpose, and intend to aid in its commission. (*Kidron, supra*, at p. 1582.)

1. Formation and Operation of a Conspiracy

a. *Evidence of conspiracy*

In ruling on the summary judgment motion, the court decided: “[t]he trier of fact could also find that PwC struck a deal with Hillman that PwC would return its documents and not expose the fraud in exchange for being paid for its work.” Appellants contend this alone demonstrates there was sufficient evidence of a conspiracy. Because we review the summary judgment ruling *de novo*, however, we examine the evidence anew. (See *Merrill v. Navegar, Inc.* (2001) 26 Cal.4th 465, 476.)

As the party moving for summary adjudication, PwC submitted evidence inconsistent with the formation of a conspiracy: PwC refused to issue a clean opinion once it uncovered the falsified PinnFund financial statements; and it communicated the finding of fraud to PinnFund’s auditor Levitz, who, PwC knew, had a duty to disclose and did disclose the matter to HUD. Furthermore, it could be inferred that the reporting options PwC noted (including the selected option of “no report”) and its disclosure of the apparent PinnFund fraud only to Hillman and Kodzis at Peregrine were not indicia of a conspiracy, but merely implementation of standards set forth in GAAS. (See GAAS, §§ 316, 317 [discussed, *post*]; see generally Cal. Code Regs., title 16, § 58 [requiring accountants to comply with GAAS].) The burden shifted to appellants, as the party opposing summary adjudication, to create a triable issue of material fact.

Appellants primarily rely on evidence that PwC offered not to issue the written audit reports, agreed to return certain documents to Hillman, destroyed its external workpapers, did not report the fraud directly to Investors, denied knowledge of the forgeries to the SEC, and otherwise kept silent about the fraud. Just as this evidence, taken together, indicates substantial assistance for aiding and abetting liability, it circumstantially suggests a conspiracy with Peregrine/Hillman to conceal the apparent fraudulent financial information of PinnFund. In other words, while a trier of fact *could* reasonably infer from PwC’s actions that it was merely operating within GAAS guidelines, the trier of fact could *also* reasonably infer from the evidence that PwC was acting pursuant to a conspiracy. The competing inferences confirm the existence of a disputed issue of material fact.¹¹

¹¹ The fact that PwC knew Levitz was aware of the fraudulent PinnFund financials and had to disclose it to HUD, and the fact that PwC was ultimately paid only about \$11,000 toward its audit work, certainly casts doubt on the *wisdom* of entering into a conspiracy with Peregrine/Hillman, if not the likelihood that any conspiracy was formed. Indeed, appellants do not articulate any compelling reason PwC would have entered into the conspiracy. It may also be argued that PwC’s failure to issue an audit report or disclaimer of opinion was not because PwC conspired with Peregrine/Hillman, but because it was fired by Peregrine/Hillman—PwC was therefore never in a position to

Thus, for purposes of avoiding summary adjudication, appellants submitted sufficient evidence that PwC entered into an agreement with Peregrine/Hillman not to disclose PinnFund’s fraudulent financials to Investors, in an audit report or otherwise. And yet two questions remain: (1) did the agreement to conceal *this* fraud occur with actual knowledge of, and intent to further, the *larger* fraudulent scheme of Peregrine/Hillman and PinnFund/Fanghella to rob investors of their money; and (2) was the failure to disclose the fraud a breach of PwC’s independent duty to appellants? We briefly address the first issue, because it may have contributed to the trial court’s ruling; the latter issue, raised in PwC’s briefs, is dispositive.

b. The trial court’s ruling and scope of the conspiracy

Acknowledging there might be sufficient evidence that PwC was aware of Peregrine/Hillman’s plan to commit fraud, the trial court concluded the evidence would not “support a finding that PwC *agreed* with Hillman and *intended* that the fraud be committed.” (Italics added.) At first this appears inconsistent with the court’s other finding that a jury could conclude PwC agreed with Hillman to return documents and not expose the fraud. On further consideration, it might reflect a distinction between PwC’s agreement to conceal the fact of the bogus financial papers, and its alleged actual intention or desire to help the overarching fraudulent scheme succeed at robbing investors of their money. In any event, the court concluded the evidence was insufficient to raise an inference that PwC agreed upon and intended that the fraud be committed, because (1) PwC was merely providing auditing services to Allied and Grafton and (2) PwC had no special interest in furthering Peregrine/Hillman’s fraud on Six Sigma. (See *Kidron*, *supra*, 40 Cal.App.4th at p. 1591 [defendant must have a “special interest” in furthering the wrongdoing].)

issue a report. But these matters do not *necessarily* preclude a reasonable trier of fact from deciding, in the totality of the circumstances, that PwC for whatever reason agreed with Hillman to conceal the fraudulent PinnFund financials from the Investors, with full knowledge that investors would be harmed by PwC’s and Hillman’s concealment.

As to the first point, the pertinent agreement was not a routine commercial contract: as appellants argue, the subject contract is not PwC's initial agreement to provide auditing services to Allied and Grafton, but PwC's subsequent agreement with Hillman, made with knowledge of his fraud, by which it promised to return its file to Hillman and refrain from issuing an audit report. PwC's agreement to remain silent about the fraud was not compelled by its contractual obligations under the audit engagement letter.

The second point—pertaining to whether PwC had a “special interest” in the fraud on appellants—requires consideration of *Kidron*. There, the court was concerned that the defendant must not only know of the coconspirator's wrongdoing but also intend its commission, and establishing such intent requires an interest in the wrong occurring, beyond the ordinary interest in performing one's contractual duties. (*Kidron, supra*, 40 Cal.App.4th at p. 1591.) There was no evidence in *Kidron* that the defendant had done anything other than perform its contractual duties, and in fact the accomplishment of the wrongdoing was actually contrary to the defendant's interests. (*Ibid.*) In the matter before us, however, PwC went beyond the *obligations* of its contract and opted not to disclose the ostensible fraud, and the fraud on Six Sigma and the Investors was not necessarily contrary to PwC's interests. From this the requisite intent may be inferred, and *Kidron* does not preclude appellants' conspiracy claim.

The analysis next turns to a closer question—the *scope* of the fraudulent scheme that PwC knew and intended to further. Appellants do not claim that PwC agreed and intended for the *overall* scam to be successful—i.e., that Peregrine/Hillman and PinnFund would successfully defraud the partnerships and Investors through investments siphoned off by Fanghella. But PwC did have actual knowledge that Peregrine and PinnFund had delivered bogus financial statements, and from this it could be inferred that PwC knew they were attempting to mislead the partnerships' auditors and, accordingly, the partnerships and their investors. PwC also knew that Peregrine/Hillman had knowledge of this fraud, was neither surprised nor concerned, and appeared bent on soliciting further investments in PinnFund.

This evidence was sufficient to raise a triable issue as to whether there was an agreement *not to disclose the fact of the PinnFund fraudulent financial statements to the investors*. In other words, a trier of fact could conclude that PwC agreed and intended to aid the concealment of Peregrine/Hillman, which itself was tortious since Peregrine/Hillman, as general partner, had a duty of disclosure to the partnerships and limited partner Investors, as well as to Six Sigma as its managing member. (See Civ. Code, §§ 1709, 1710(3); *Stevens v. Superior Court* (1986) 180 Cal.App.3d 605, 609.)

Urging a broader construction of the conspiracy—such that PwC joined in the overall conspiracy to steal from investors—appellants point out that not all conspirators must perform or agree to perform *all* of the overt acts that further a conspiracy, and concealment of part of the fraud may be its role in the operation of the overall scheme. (See *Applied Equipment, supra*, 7 Cal.4th at p. 511.) Appellants also urge that concealment of fraud may be viewed as tacit approval of the fraudulent scheme. (*Wyatt v. Union Mortgage Co.* (1979) 24 Cal.3d 773, 785.) And, regardless of any actual desire that the victims be harmed, a person who acts willfully is generally presumed to intend the natural and probable consequences of his actions. (See *Gomez v. Acquistapace* (1996) 50 Cal.App.4th 740, 746.)

In the end, we need not resolve the scope of the purported conspiracy. As we next discuss, appellants have no conspiracy claim at all against PwC as a matter of law—no matter how broad the conspiracy’s scope may be described in fact—because PwC did not owe appellants a duty owed by PwC’s purported coconspirators.

c. No independent duty

As a matter of law, a party cannot conspire to breach a duty it does not already owe. (See, e.g., *Applied Equipment, supra*, 7 Cal.4th at p. 514 [“Conspiracy . . . allows tort recovery only against a party who already owes the duty.”]; *Doctors’ Co. v. Superior Court* (1989) 49 Cal.3d 39, 44 [“A cause of action for civil conspiracy may not arise . . . if the alleged conspirator, though a participant in the agreement underlying the injury, was not personally bound by the duty violated by the wrongdoing”].) PwC insists it cannot be liable for conspiring to conceal information from Six Sigma and the Investors,

because neither Six Sigma nor the Investors were PwC's clients, and PwC owed them no duty of disclosure. (See generally Civ. Code, § 1710, subd. (3) [suppression of fact is actionable if the defendant had a duty to disclose the fact or gave other information that was likely misleading due to nondisclosure of the suppressed fact]; *LiMandri v. Judkins* (1997) 52 Cal.App.4th 326, 336 [nondisclosure is not actionable fraud unless there was a duty to disclose or other circumstances requiring disclosure] (*LiMandri*); *Bily v. Arthur Young & Co.* (1992) 3 Cal.4th 370, 406 [auditor's negligence liability generally limited to client] (*Bily*).)¹²

On this point, PwC emphasizes that the engagement agreement required PwC to report this fraud only to "you," meaning general partner Peregrine, not the limited partner Investors. Appellants counter by contending: (1) the engagement agreement should be read to create a *contractual* duty in PwC to report directly to the limited partner Investors; (2) like every other entity or person, PwC had a *general* duty in tort to refrain from defrauding anyone else; and (3) PwC had a *specific* duty in tort to report the fraud to the limited partners.

Appellants' arguments are not convincing. As to PwC's contractual duty under the engagement letter, the parties' agreement is unambiguous and by its terms compels reporting only to the general partner. We discuss this further in the context of the Investors' third party beneficiary claim, *post*.

Appellants' assertion of a general duty not to defraud others misses the mark as well. For the most part, a plaintiff cannot maintain a fraud cause of action merely because it was harmed by a defendant's misrepresentation or nondisclosure to someone

¹² A defendant may be liable for fraud in not disclosing a material fact to the plaintiff if the defendant: (1) was in a fiduciary relationship with the plaintiff; (2) had exclusive knowledge of the fact; (3) actively concealed the fact from the plaintiff; or (4) made partial representations that were misleading due to the omitted fact. (*LiMandri, supra*, 52 Cal.App.4th at p. 336.) PwC did not have a fiduciary relationship with appellants, was not the only one who knew of the forged PinnFund financials, did not take steps beyond mere nondisclosure to actively conceal the fraud, and made no representations to appellants.

else, unless the defendant actually intended for the plaintiff *himself* to rely upon the representation or omission. In limited circumstances, a plaintiff may sue a defendant based on an affirmative misrepresentation or nondisclosure the defendant made to a third party, if the defendant intended or had reason to expect that the plaintiff also would rely on it. (See, e.g., *Geernaert v. Mitchell* (1995) 31 Cal.App.4th 601, 605 [causes of action for fraud and concealment stated against defendants, who misrepresented or failed to disclose defects in property when selling it, with the expectation that those misrepresentations and nondisclosures would be passed on to plaintiffs] (*Geernaert*); *Shapiro v. Sutherland* (1998) 64 Cal.App.4th 1534, 1548 [defendant could be liable for indirectly deceiving plaintiff because it knew the party to whom it made the misrepresentation would pass it on to subsequent purchaser] (*Shapiro*); see generally Rest.2d Torts, § 533.) There is arguably a superficial similarity between such circumstances and the matter before us: by helping Hillman conceal the fraudulent PinnFund statements, PwC allegedly intended or had reason to expect that the limited partners, and perhaps Six Sigma, would rely on the absence of a report of fraud.

Closer consideration, however, confirms that PwC had no duty of disclosure to the limited partners or to Six Sigma. In *Geernaert* and *Shapiro*, the defendants had *failed* to disclose material facts to the party to whom they owed a direct and primary duty of disclosure—their respective purchasers. One of the defendants had taken extraordinary measures to conceal the property’s true condition, so it knew a later purchaser would very likely be deceived as well. (*Geernaert, supra*, 31 Cal.App.4th at p. 608.) Another defendant, by its nondisclosure, deprived its original buyer of the truth about the condition of the property, thus rendering the original buyer *unable* to relate the true status of the property to the subsequent-purchaser plaintiff. (*Shapiro, supra*, 64 Cal.App.4th at p. 1548.)

In the matter before us, by contrast, PwC’s direct and primary duty of disclosure was to the partnerships. PwC *disclosed* the fraud to the partnerships by communications with their general partner, who could have—and purportedly should have—advised appellants. While PwC did not prepare an audit report or otherwise disclose the fraud, it

did nothing extraordinary to conceal it from the investors to whom the general partner had a duty to disclose. And although PwC suspected that Peregrine/Hillman would probably not pass along the information to appellants, this fact alone is insufficient to create an independent legal *duty* to appellants to inform the limited partners (let alone Six Sigma).¹³

For similar reasons, appellants' argument that PwC owed them a specific duty to disclose the fraud also fails. Appellants in this regard rely on the testimony of their expert witnesses, who opined that PwC should have gone beyond Peregrine/Hillman in light of Peregrine/Hillman's ostensible complicity in the fraud. As we discussed *ante*, in the context of appellants' aiding and abetting claim, this evidence does create a triable issue as to whether PwC's *standard of care*, in fulfilling its *duty to Grafton and Allied*, obligated it as a factual matter to disclose the fraud to limited partners. But that is not the same thing as a legal *duty* owed *directly to the Investors* to make this disclosure. Due to this distinction, PwC's claim for aiding and abetting survives summary adjudication in light of a triable dispute on a factual matter, but appellants' conspiracy-based claim fails as a matter of law. (See generally *Neilson, supra*, 290 F.Supp.2d at pp. 1133-1136 [discussing distinction between aiding and abetting theory and conspiracy theory]; *Saunders, supra*, 27 Cal.App.4th at pp. 845-846 [setting forth elements of civil conspiracy and distinct basis for liability as aider and abettor].)

In sum, Six Sigma and the Investors have no conspiracy claim against PwC as a matter of law, based on the evidence presented to the trial court, and thus the court did not err in dismissing appellants' conspiracy claim.

¹³ At oral argument in this appeal, appellants referred us to Civil Code section 3333, claiming that all persons proximately harmed by fraud can sue and recover damages. Civil Code section 3333 provides: "For the breach of an obligation not arising from contract, the measure of damages, except where otherwise expressly provided by this code, is the amount which will compensate for all the detriment proximately caused thereby, whether it could have been anticipated or not." (See also Civ. Code, § 3343 [recovery for fraud].) But this section governs the scope of recoverable damages by those with standing to sue; it does not create a cause of action against a defendant who owed no duty of care.

D. THIRD PARTY BENEFICIARY CLAIMS

The Investors contend their claims for breach of contract and professional negligence should not have been dismissed, because they are third party beneficiaries to the auditing agreement between PwC and Grafton and Allied. More precisely, they argue a trier of fact could determine that the Investors were intended third-party beneficiaries of the specific provision in the engagement letter by which PwC agreed to “communicate to *you*, as appropriate, any illegal act, material errors, or evidence that fraud may exist as identified during our audits.” (Italics added.)

The word “you” in the engagement agreement refers to the general partner, Peregrine/Hillman, not to the Investors.¹⁴ An auditor’s liability for professional negligence in the conduct of an audit of its client’s financial statements is generally limited to the person who engaged the audit services—again, Peregrine/Hillman. (*Bily*, *supra* 3 Cal.4th at p. 406.)

In some circumstances, the auditor may be liable to an intended third party beneficiary of the engagement agreement, but to be an intended third party beneficiary the audit engagement contract would have to “*expressly* identify a particular third party or parties.” (*Bily*, *supra*, 3 Cal.4th at p. 406, fn. 16, italics added.) The engagement letter here does not expressly identify the Investors. Furthermore, because an audit report by its nature has potential widespread third party impact, additional factors must be present to warrant standing as third party beneficiaries, so there are *no* “express third party beneficiaries” of an ordinary audit engagement contract. (*Mariani v. Price Waterhouse* (1999) 70 Cal.App.4th 685, 701 (*Mariani*).)

In the present case, the engagement agreement not only omits any mention of the

¹⁴ Although the engagement letter was plainly addressed to Peregrine, the letter also referred at one point to the “agreements *of the Partnerships* and PricewaterhouseCoopers LLP contained in this engagement letter.” (Italics added.) This no doubt reflects the obvious fact that Peregrine was acting on behalf of the partnerships in agreeing to the engagement; it does not suggest that the one to whom PwC should *report* would be anyone other than the partnerships’ general partner.

Investors (limited partners), it expressly attempts to negate the possibility of third party beneficiaries. It provides that the engagement is with “Grafton Partners and Allied Capital Partners (the ‘Partnerships’).” The engagement letter also specifies: “Our audits are intended for the benefit of the Partnerships. The audits will not be planned or conducted in contemplation of reliance by any third party” The Investors were not intended third party beneficiaries of the engagement agreement.

Appellants’ arguments to the contrary are unpersuasive. First, the Investors refer us to cases standing for the proposition that a third party beneficiary need not be expressly named in the contract. (*Outdoor Services, Inc. v. Pabagold, Inc.* (1986) 185 Cal.App.3d 676, 679 (*Outdoor Services*); *Lucas v. Hamm* (1961) 56 Cal.2d 583, 586 (*Lucas*); *Harper v. Wausau Ins. Co.* (1997) 56 Cal.App.4th 1079, 1082 (*Harper*)). These cases did not involve an audit engagement contract, which is significant in light of its distinguishing characteristics. (*Mariani, supra*, 70 Cal.App.4th at p. 701.) We note as well that *Outdoor Services* and *Lucas* predated *Bily* and *Mariani*, and *Harper* did not mention either decision.¹⁵ In any event, even if it were unnecessary for the limited partners to be referred to by name in the engagement letter, the omission of any reference

¹⁵ At oral argument, the Investors relied on *Mariani* for the proposition that a third party does not have to be expressly named in the contract, because *Mariani* quoted the following passage from *Outdoor Services*: “It is not necessary that an express beneficiary be specifically identified in the contract; he or she may enforce it if he or she is a member of a class for whose benefit the contract was created.” (*Mariani, supra*, 70 Cal.App.4th at p. 699, quoting *Outdoor Services, supra*, 185 Cal.App.3d at p. 681.) Appellants are incorrect. In the first place, the court in *Mariani* merely noted this language in *Outdoor Services* when it assumed *Bily* did not narrow traditional precepts of third party beneficiary law; but the *Mariani* court then ruled that even these traditional precepts of third party beneficiary law—as applied in the context of audit reports—*barred* the subject third party beneficiary claim. (*Mariani, supra*, at pp. 699-700.) We reach the same conclusion here. Furthermore, appellants are not aided by the proposition that a party who is not specifically identified in a contract can enforce the contract as a member of a beneficiary class. If there was any “class” for which the engagement letter was formed, it was the limited partnerships. Thus, Grafton and Allied, as the limited partnerships, could perhaps enforce the engagement letter even if they had not been mentioned by name in the agreement. The Investors, however, were not members of any “class” for whom the engagement letter was formed.

to “limited partners,” *and* the express language that the audits were intended for the benefit of the partnerships, confirms that it was not the intent of the contracting parties that the limited partners would be third party beneficiaries of the engagement letter.

Second, appellants contend it was *implied*, as a matter of industry practice or law, that limited partners would be beneficiaries of PwC’s undertaking to disclose evidence of fraud. They argue that, although the engagement agreement did not expressly identify the Investors, its legal effect is the same, because contracts for professional services are deemed by California law to incorporate the prevailing standards of practice and therefore contractually obligate the professional to adhere to those standards. This has no merit, because it would require us to imply a term contrary to the plain meaning of the unambiguous words of the contract.

Lastly, appellants urge, the express term “to you” should be *interpreted* to include the owners of the enterprise (limited partners) because the main purpose of the audit was to protect the partnerships. As appellants note, contracts are to be interpreted to avoid absurdity, to make them operative and reasonable, and in light of commercial custom and practices. (Civ. Code, §§ 1638, 1643, 1655.) Appellants’ argument ultimately lacks merit, however, because it would require us to interpret the contract contrary to its plain meaning, which is neither ambiguous, unworkable, nor unreasonable.

The trial court was correct in dismissing the third party beneficiary claims.¹⁶

¹⁶ Appellants contend it is a question of fact whether a party was an intended third party beneficiary of the contract. The very case on which they rely, however, confirms that we may conclude as a matter of law that the Investors were not third party beneficiaries of the engagement agreement: “Generally, it is a question of fact whether a particular third person is an intended beneficiary of a contract. [Citation.] However, *where, as here, the issue can be answered by interpreting the contract as a whole and doing so in light of the uncontradicted evidence of the circumstances and negotiations of the parties in making the contract, the issue becomes one of law that we resolve independently.*” (*Prouty v. Gores Technology Group* (2004) 121 Cal.App.4th 1225, 1233, italics added.)

III. DISPOSITION

The judgment is reversed. Appellants shall recover their costs on appeal from respondent.

STEVENS, Acting P.J.

We concur.

SIMONS, J.

GEMELLO, J.

Trial Judge:

Hon. Ronald M. Sabraw

Trial Court:

Alameda County Superior Court

Counsel for Plaintiffs and Appellant:

Jerome B. Falk, Jr.
Steven L. Mayer,
Howard Rice Nemerovski Canady Falk
& Rabkin,
John J. Bartko,
Christopher J. Hunt,
Allan N. Littman,
Bartko, Zankel, Tarrant & Miller

Counsel for Defendant and Respondent:

Daniel M. Kolkey,
Scott A. Fink,
Daniel P. Muino,
Gibson, Dunn & Crutcher