UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY
Newark Vicinage

CHATHAM ASSET MANAGEMENT, LLC, Plaintiff, v. ADVISER COMPLIANCE ASSOCIATES, LLC D/B/A ACA COMPLIANCE GROUP, Defendant.	CIVIL ACTION NO: 2:23-cv-02677-MCA-JSA **Motion Day: July 3, 2023**

DEFENDANT ADVISER COMPLIANCE ASSOCIATES, LLC'S MEMORANDUM OF LAW IN SUPPORT OF ITS MOTION TO DISMISS PLAINTIFF'S COMPLAINT FOR FAILURE TO STATE A CLAIM

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I. PRELIMINARY STATEMENT

By this action, Plaintiff Chatham Asset Management, LLC ("Chatham") seeks to foist blame on Adviser Compliance Associates, LLC ("ACA") for Chatham's own violations of federal securities laws and Securities and Exchange Commission ("SEC") rules.[1] As set forth in the SEC's April 3, 2023 public Cease & Desist Order at the center of this action, the SEC found that Chatham and one of its principals, Anthony Melchiorre, violated SEC regulations by pre-arranging the price at which certain brokers would buy and sell specific high-yield bonds for the accounts of investment funds that Chatham managed ("Rebalancing Trades"). By setting the value at which it would sell and re-purchase the bonds, Chatham assured that its bonds would continue to increase in purported value, thereby increasing the value of the managed funds on which its fees were based, without actually bearing any true market risk of price fluctuations.

Shortly after the SEC's Order[2] was released, Chatham sued ACA, claiming that its violations resulted from ACA's allegedly incorrect advice regarding

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[1] ACA accepts the allegations in the Complaint for purposes of this motion only but reserves all rights to challenge them if this motion is not granted.

[2] The Court should take judicial notice of the SEC's public findings in the Cease and Desist Order because they are integral to Chatham's allegations that ACA's allegedly deficient professional services led to those findings, and Chatham's characterization of the SEC's findings is incomplete. SEC filings are "matters of public record of which the court can take judicial notice." *Schmidt v. Skolas*, 770 F.3d 241, 249 (3d Cir. 2014); *SEPTA v. Orrstown Fin. Servs., Inc.*, 2016 WL

compliance with SEC regulations restricting cross-trading, and ACA's subsequent failure to identify the unlawful Rebalancing Trades in ACA's annual compliance reviews of Chatham's regulatory compliance program. Significantly, the SEC found that Chatham and Mr. Melchiorre were pre-arranging the price of the so-called Rebalancing Trades, rather than allowing the price to be set by third-party transactions through a free market process. Nothing in the Complaint, however, alleges that Chatham ever informed ACA that it was pre-arranging the sales prices of the bonds, or that ACA knew of the practice, much less that ACA advised Chatham to engage in it. On these fatally defective allegations, Chatham asserts claims for breach of contract, gross negligence, negligent misrepresentation, and breach of fiduciary duty. As a matter of law, on the face of the Complaint and documents incorporated by reference, the Complaint fails to state a claim against ACA and should be dismissed.

In summary:

First, Chatham's claims are time-barred by the applicable two- and three-year statutes of limitations under Delaware law. Chatham's claims are governed by the parties' contracts attached to the Complaint – *i.e.*, the Non-Privileged Agreement

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7117455, at *6 (M.D. Pa. Dec. 7, 2016) (taking judicial notice of a similar SEC Order in connection with a motion to dismiss) (a copy of this decision is attached as Exhibit 1 to the Declaration of Nicole E. Crossey ("Crossey Decl.")). *See also* note 3 below.

and the 2010 and 2013 Privileged Agreements (collectively, the "Privileged Agreements") (Exhibits A-C to the Complaint). Those contracts contain choice of law provisions selecting Delaware law.[3] All of ACA's alleged conduct took place in 2019 or earlier, more than three years before Chatham filed this suit in April 2023. Thus, based on the face of the Complaint, all of Chatham's claims are time-barred.

Second, even if Chatham's claims are not time-barred (which they are), the Complaint fails to state a claim as a matter of law:

Breach of Contract Claims (Counts One and Two) – The gravamen of Chatham's breach of contract claims is that ACA must have failed to provide

[3] Because Chatham attaches the parties' contracts as exhibits to the Complaint and relies upon the SEC Cease and Desist Order, the Court may consider these documents on this Motion to Dismiss without converting it into a Rule 56 motion for summary judgment. *Lum v. Bank of Am.*, 361 F.3d 217, 221 n.3 (3d Cir. 2004) (the record on a motion to dismiss includes exhibits attached to the complaint); *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1426 (3d Cir. 1997) ("[A] document integral to or explicitly relied upon in the complaint may be considered without converting the motion [to dismiss] into one for summary judgment"). As the Third Circuit explained in *Burlington Coat Factory*, "[t]he rationale underlying this exception is that the primary problem raised by looking to documents outside the complaint – lack of notice to the plaint[iff] – is dissipated where plaintiff has actual notice … and has relied upon these documents in framing the complaint." *Id.* The exception allowing review of centrally important documents is grounded in common sense: "Otherwise, a plaintiff with a legally deficient claim could survive a motion to dismiss simply by failing to attach a dispositive document on which it relied." *Pension Benefit Guar. Corp. v. White Consol. Indus., Inc.*, 998 F.2d 1192, 1196 (3d Cir. 1993); *see also Burlington Coat Factory*, 114 F.3d at 1426 ("Plaintiffs cannot prevent a court from looking at the texts of the documents on which its claim is based by failing to attach or explicitly cite them"). A copy of the SEC Cease and Desist Order is attached as Exhibit 2 to the Crossey Declaration.

"accurate" compliance advice and reviews because the SEC later determined, after years of investigation, that certain Rebalancing Trades were illegal cross trades. Nowhere, however, does Chatham identify any specific provision of any contract that ACA breached or any legally cognizable harms as a result thereof. Moreover, the contracts expressly provide that ACA would *not* bear the risk of regulatory noncompliance by Chatham. Hence, Chatham's breach of contract claims fail for two independent reasons: (1) Chatham does not identify any contractual obligation that ACA breached or any resulting damages and (2) the parties expressly contracted that ACA would not bear the risk of an adverse action by the SEC.

Tort Claims (Counts Three, Four, and Five) – Chatham also alleges three tort claims: gross negligence (Count Three), negligent misrepresentation (Count Four), and breach of fiduciary duty (Count Five), all of which are barred by the "economic loss doctrine," adopted in Delaware. Under that doctrine, because the parties' relationship is based on professional services contracts, Chatham is barred from seeking recovery in tort for strictly economic losses arising from the parties' relationship. Therefore, each tort claim fails as a matter of law. Moreover, Chatham has failed, in any event, to allege facts plausibly supporting each element of the tort claims, as discussed in the Argument below. Accordingly, Chatham fails to state a claim upon which relief may be granted and its Complaint should be dismissed.

II. STATEMENT OF FACTS

A. The Parties and Nature of the Action

Chatham is a hedge fund management company. Compl. ¶ 9. ACA provides governance, risk, and compliance advisory services primarily to financial services firms. *Id.* ¶ 15. Chatham alleges that ACA failed to provide adequate compliance advice or to conduct proper "annual compliance program review[s]"[4] with respect to certain trades that Chatham executed in third-party funds that it managed from 2016 to 2018. *Id.* ¶¶ 1, 18, 29. In the so-called Rebalancing Trades at issue, Chatham would direct a sale by one of its client funds of certain high-yield debt securities and a purchase of the same securities for another of its client funds, in each case through an intermediary broker-dealer. *Id.* ¶ 29.

[4] Chatham's Complaint refers to ACA's annual compliance program reviews as "mock audits." *See, e.g.*, Compl. ¶ 3. However, the parties' contracts refer to these annual reviews as "annual compliance program reviews" and explicitly recognize that the annual reviews were not audits:

> ACA does not offer legal or accounting services, nor does it provide substitute services for those provided by legal counsel or certified public accountants. … Although ACA's work may involve analysis of accounting and financial records, **this engagement is not an audit of [Chatham] in accordance with accepted auditing standards, nor is it a review of the internal controls of [Chatham] in accordance with … authoritative accounting literature.**

Id. at Ex. A § 2 p. 3 (Non-Privileged Agreement); *Id.* at Ex. B § 2 p. 3 (2010 Privileged Agreement) (emphasis added).

Following an extended SEC inquiry and subsequent investigation of Chatham's trading practices, discussed below, the SEC initiated administrative proceedings and published a Cease and Desist Order on April 3, 2023 against Chatham and Mr. Melchiorre for alleged violations of the Investment Company Act of 1940 ("Investment Company Act") and Investment Advisers Act of 1940 ("Advisers Act"), *In re Matter of Chatham Asset Management LLC and Anthony Melchiorre*, File No. 3-21355. *Id.* ¶¶ 5-6, 67; SEC Order § III ¶¶ 1-3. Without "admitting or denying" the SEC's findings, Chatham offered a settlement, which the SEC accepted, including disgorgement of $11,000,000 in management fees that were collected as a result of the inflated values (the "Disgorgement"), payment of pre-judgment interest of $3,375,072 (the "Pre-Judgment Interest"), and payment of civil penalties totaling $5,000,000. Compl. ¶ 67; SEC Order § IV.G.

Chatham subsequently filed this lawsuit seeking to blame ACA for the SEC's findings and for recovery of "no less than $100 million," including the Disgorgement and the Pre-Judgment Interest, plus an additional "$75 million in advisory fees" as well as "amounts reflecting alleged reputational harm." Compl. at Wherefore Clause.

B. The Parties and Their Contractual Relationship

When Chatham first retained ACA in 2010, Chatham was in the business of managing the assets of privately owned high-yield funds or managed accounts. *Id.* ¶¶ 16, 26. The parties' first agreement, the "Non-Privileged Agreement," effective as of

November 1, 2010, is Exhibit A to the Complaint. *Id.* ¶ 16. Chatham alleges that under the Non-Privileged Agreement, ACA agreed to provide compliance support and help Chatham with the forms necessary to become a registered investment adviser. *Id.* ¶ 17.[5] The parties agreed that the contract would be governed and construed in accordance with Delaware law. *Id.* at Ex. A § 8 p. 9 ("This Agreement shall be governed by, and construed in accordance with, the laws of the State of Delaware.").

The Non-Privileged Agreement expressly acknowledged that the parties were independent contractors and had no fiduciary relationship between them:

> In connection with this Agreement, each party shall act as an **independent contractor to the other**, not as an agent…. **Nothing herein shall be deemed or construed to create a … fiduciary relationship between the parties hereto for any purpose**, nor to authorize either party to create any obligation, express or implied, on behalf of the other.

Id. at Ex. A § 2 p. 4 (emphasis added). Furthermore, the parties agreed that ACA would exercise its professional judgment in focusing on selected topics, reviews, and procedures, not on everything all at once:

> In providing the Services, ACA may, in its professional judgment, place relatively greater focus on specific topical areas and/or specific reviews or procedures based on Client's unique business operations, investment strategies, product offerings, or risks, current SEC and other regulatory focus areas, and/or Client's subsequent instruction or request. ACA does not agree to provide any services that are not expressly set forth in this Agreement.

[5] Chatham became a registered investment adviser in 2012. Compl. ¶ 26.

Id. at p. 2. Importantly, the parties expressly recognized that ACA disclaimed the risk of adverse SEC action and disclaimed any "absolute" assurance that Chatham would have an effective compliance program as a result of ACA's Services:

> **ACA does not guarantee that the Services will be favorably received by the SEC or any other regulatory agency. The Services are designed to help provide reasonable, but not absolute, assurance to Client that Client has, or will have, an adequate and effective compliance program with respect to the areas that are covered by the Services**. Because the Services are designed to help provide reasonable, but not absolute, assurance and because ACA will not perform a detailed inspection of all of Client's books and records and transactions **there is a risk that material issues or deficiencies**, fraudulent activity, misappropriation of assets, or violations of law, which may exist, **will not be detected during the course of this engagement**.
>
> In addition, and due to the characteristics of fraud, a properly planned and performed engagement may not detect fraudulent activity, misappropriation of assets, or violations of law. ACA will report to Client any fraudulent activity relating to Client that comes to ACA's attention during the course of the engagement. **Client acknowledges that it is ultimately responsible for the design, implementation, and maintenance of its compliance program**.

Id. at pp. 2-3 (emphasis added). The parties further agreed that ACA would have no liability to Chatham except for gross negligence, willful misconduct or fraudulent behavior:

> As a matter of risk management, … **ACA … shall not be liable to Client** for any and all claims relating to this Agreement or the Services provided by ACA hereunder, whether a claim be in tort, contract, or any other theory of law, and whether by statute or otherwise, … **except to the extent such claim arises from ACA['s] gross negligence, willful misconduct or fraudulent behavior.**

Id. at § 5 p. 6 (emphasis added). Additionally, the parties expressly acknowledged that it was Chatham's responsibility to provide complete and accurate information to ACA, and that ACA did not assume any responsibility for any inaccuracies or incompleteness in the information provided by or on behalf of Chatham:

> **Client acknowledges and agrees that it retains sole responsibility and obligation for the accuracy and completeness of the records and data submitted by client to ACA** in connection with ACA's performance of the Services. Accordingly, Client agrees that ACA shall not have and **ACA hereby disclaims, any responsibility** … whether arising from tort, contract, or any other theory of law, **resulting from any inaccuracy in the records and data provided by Client** or on Client's behalf by any third party.

Id. (emphasis added).

The second agreement, the "2010 Privileged Agreement," was between ACA and Chatham's outside counsel, Seward & Kissel LLP, also effective as of November 1, 2010 and attached as Exhibit B to the Complaint. *Id.* ¶ 16. This contract was designed so that ACA would render services at the direction of Seward & Kissel LLP with Chatham as a third-party beneficiary responsible for paying ACA's fees. *Id.* ¶ 18. ACA's work included an annual compliance program review, SEC examination support, and review of policies, procedures, and compliance documents. *Id.* The 2010 Privileged Agreement contains language virtually identical to the Non-Privileged Agreement referenced above:

- ACA and Seward & Kissel had no fiduciary relationship (*id.* at Ex. B § 2 p. 4);

- The parties agreed that Delaware law governed the Agreement (*id.* at § 8 p. 9);
- ACA could use its professional judgment to focus on selected topical areas, reviews, or procedures (*id.* at § 2 p. 2);
- ACA disclaimed the risk of adverse SEC action (*id.* at pp. 2-3);
- ACA disclaimed responsibility for any inaccuracies or incompleteness in the information provided by or on behalf of Chatham or Seward & Kissel (*id.* at § 5 p. 7); and
- ACA's liability to Chatham and Seward & Kissel would be limited to gross negligence, willful misconduct or fraudulent behavior (*id.*).

In 2013, Chatham expanded its client base to include sub-advisory services to publicly registered, multi-manager, liquid alternative funds ("LAFs"). *Id.* ¶ 26. In recognition that some of the LAFs were registered investment companies subject to the Investment Company Act, the parties amended the 2010 Privileged Agreement effective May 30, 2013 ("2013 Privileged Agreement"), which is attached as Exhibit C to the Complaint. *Id.* ¶¶ 2, 22, 27, 30. Under the 2013 Privileged Agreement, ACA agreed, among other things, to conduct a "limited-scope annual review" in compliance with the Investment Company Act. *Id.* ¶¶ 22-24; Ex. C at § 1 p. 2. This agreement further provided that "[e]xcept as otherwise amended, the terms and provisions of the [2010 Privileged Agreement], including the rights and obligations

of ACA, [Seward & Kissel, and Chatham], remain unmodified and in full force and effect." *Id.* at Ex. C § 2 p. 2.

After the SEC commenced its investigation of Chatham in 2019, the parties continued to work together. They amended and replaced the 2013 Privileged Agreement with the "2020 Privileged Agreement," effective November 1, 2020 and attached as Exhibit D to the Complaint. *Id.* ¶ 24. The 2020 Privileged Agreement contained provisions that were largely identical to those referenced above in the 2010 and 2013 Privileged Agreements. The major exceptions were that the 2020 Privileged Agreement: (1) provided that ACA's liability in the event of a breach not rising to the level of gross negligence, willful misconduct, or fraudulent behavior was limited to $1 million plus the annual fees Chatham paid; and (2) contained a choice of law provision selecting New York law, rather than Delaware law. *Id.* at Ex. D § 5 p. 8 and § 8 p. 11. In other words, even after the SEC began investigating Chatham's Rebalancing Trades, Chatham maintained its relationship with ACA—that is, until Chatham's blame-shifting about-face after publication of the SEC's findings.

C. The Rebalancing Trades and ACA's Purported Compliance Advice and Reviews

Chatham alleges that during the "Relevant Period," which it defines as January 2016 to December 2018, its LAF clients were subject to concentration limits in certain high yield bonds (citing American Media Inc. ("AMI") bonds). *Id.* ¶¶ 28-29. As a result, Chatham was "forced to" "rebalance" the portfolio of some LAF

clients by selling those bonds from time to time in order to maintain positions in the bonds that did not exceed the negotiated thresholds. *Id.* ¶ 29. Yet, because Chatham believed in the value of those bonds, it directed purchases of the same bonds by other Chatham funds, using "various broker-dealers" to execute the trades. *Id.*

As discussed below and according to the SEC, however, Chatham did not conduct these Rebalancing Trades at fair market value. Rather, Chatham and Mr. Melchiorre violated SEC restrictions by actively pre-arranging with brokers both the price and the certainty that Chatham would repurchase the bonds. In other words, the SEC's investigation determined that Chatham and Mr. Melchiorre executed the Rebalancing Trades at prices they expressly or tacitly agreed upon with the broker (always at a small increase in price) which had the effect of eliminating market risk and also increasing the bond price, which, in turn, resulted in higher fees being charged to Chatham's clients. SEC Order § III ¶¶ 1-2. Chatham does not allege that it ever disclosed its practice of making pre-arranged trades to ACA, but suggests that ACA somehow should have figured it out on its own and saved Chatham from its own wrongdoing.

According to Chatham, the ACA advice relevant to this dispute was given in March 2016. Compl. ¶¶ 3, 31. Chatham alleges that its Chief Operating and Compliance Officer asked an ACA partner about how to maintain compliance with SEC Rule 17a-7 in executing Rebalancing Trades, which requires, among other

things, that the transaction be "effected at the independent market price." *Id*. ¶ 30 & n. 3. The ACA partner allegedly advised Chatham:

> In sum and substance … that Chatham could engage in these trades by trading with the market using brokers to conduct the trades. He added that if the Rebalancing Trades were executed on the same day, Chatham should use more than one broker, but if the trades were done over two or more days, Chatham could use a singer broker. By trading in this manner, he explained that **the brokers were taking on risk of owning the bonds**, thereby avoiding a cross trade.

Id. ¶ 31 (emphasis added). In other words, Chatham could comply with cross-trading rules by making trades that required the brokers to assume risk and trading at the fair market value. *Id*.[6] The SEC's Order, as cited by Chatham's Complaint, confirms this:

> Recognizing that there were legal restrictions on trading between [registered investment companies] and their affiliates, which included other Chatham Clients, Chatham and Melchiorre sought advice from a compliance consultant on how to facilitate the Rebalancing Trades. The consultant advised Chatham to conduct the trading either through a single broker over more than one day or through multiple brokers if on the same day. **The foundational principle underlying the advice was to ensure that the transactions occurred at independently-derived market prices.**

SEC Order § III ¶ 18 (emphasis added). The SEC's Order does not find fault with this advice.

[6] ACA's advice, according to Chatham, ran counter to Section 17(a)(1) of the Investment Company Act, SEC Rule 17a-7, Section 206(2) of the Advisers Act, SEC Precedents (*i.e.*, SEC Rel. No. IC-11136), and other enforcement actions regulating cross trades. Compl. ¶¶ 14, 30, 34-35 & n.6, 59.

According to Chatham, however, ACA was "grossly negligent" for failure to discover that Chatham had pre-arranged the Rebalancing Trades and therefore eliminated the possibility of "independently-derived market prices" – even though Chatham does not allege that it ever told ACA what it was doing. Chatham claims that because ACA had "unfettered access" to Chatham's "trading data, emails and Bloomberg chats," ACA should have figured out that Chatham was pre-arranging the Rebalancing Trades and raised concerns in Chatham's annual compliance reviews for the years 2016 and 2017. Compl. ¶¶ 4, 50. Chatham's allegations, however, blatantly ignore the clear restrictions in the parties' contracts concerning ACA's "limited-scope" annual reviews of Chatham's regulatory compliance program. *See id.* at Ex. C at § 1 p. 2; Exs. A-B §§ 2, 5.

D. The SEC's Examination, Investigation and Enforcement Proceeding

In May 2018, the SEC notified Chatham that it would conduct an examination at Chatham's offices on July 9-11, 2018 to review certain information and documents and speak to Chatham employees. *Id.* ¶ 51. This examination identified over 100 offending cross-trades from 2016 to 2018, which Chatham alleges should have been discovered as part of the annual compliance program reviews ACA performed. *Id.* ¶ 5.

In May 2019, the SEC sent Chatham a letter setting forth deficiencies with respect to certain Rebalancing Trades that the SEC had flagged as cross-trades that

failed to comply with SEC rules. *Id.* ¶ 63. In July 2019, Chatham responded with a letter to the SEC asserting that ACA's "compliance guidance and subsequent experience validated Chatham's belief" that the Rebalancing Trades were not unlawful cross trades. *Id.* ¶¶ 64-65.

The SEC thereafter initiated a formal investigation into the Rebalancing Trades which culminated in the April 3, 2023 Cease and Desist Order for alleged violations of the Investment Company Act and Advisers Act. *Id.* ¶¶ 5-6, 67. The gravamen of the SEC's findings is that Chatham and Melchiorre violated cross-trading regulations by engaging in a course of conduct with certain brokers that resulted in agreed upon price increases between trades for the same securities, and effectively assured that the securities would not be subjected to market risk because they would be sold and promptly repurchased by a different Chatham fund for an agreed price. While Chatham notes that the SEC Order refers to ACA's advice, Chatham fails to make clear that the SEC suggested no wrongdoing by ACA or that ACA knew and advised Chatham of the pre-arranged trading pattern. *Id.* ¶¶ 6, 31, 67. Chatham settled with the SEC, without "admitting or denying" the SEC's findings. *Id.* ¶ 67.

III. ARGUMENT

A. Standard of Review

In reviewing a motion to dismiss, pursuant to Rule 12(b)(6), the Court considers "the allegations in the complaint, exhibits attached to the complaint,

matters of public record, and documents that form the basis of a claim" as well as documents that are "integral to or explicitly relied upon in the complaint." *Lum*, 361 F.3d at 221 n.3 (3d Cir. 2004) (quoting *Burlington Coat Factory*, 114 F.3d at 1426). Thus, the matters properly before this Court include the parties' contracts which are attached as exhibits to the Complaint as well as the deficiency letters exchanged between the SEC and Chatham and the SEC's Order that are referenced in the Complaint. *See* notes 2 & 3, above.

To defeat a motion to dismiss, a complaint must contain sufficient factual matter to state "a claim to relief that is plausible on its face." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009). This plausibility standard "require[s] a pleading to show more than a sheer possibility that a defendant has acted unlawfully." *Connelly v. Lane Constr. Corp.*, 809 F.3d 780, 786 (3d Cir. 2016) (internal quotation marks and citations omitted). Indeed, the purpose of the notice pleading standard is that the defendant is entitled to "fair notice of what the … claim is *and the grounds upon which it rests*." *Erickson v. Pardus*, 551 U.S. 89, 93 (2007) (quoting *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555 (2007)) (emphasis added). In other words, more is required than "labels and conclusions" and "a formulaic recitation of the elements of a cause of action will not do." *Twombly*, 550 U.S. at 555.

Nor will courts accept legal conclusions couched as factual allegations to satisfy pleadings requirements. *Iqbal*, 556 U.S. at 678. "Factual allegations must be

enough to raise a right to relief above the speculative level," *Twombly* 550 U.S. at 555, and where they do not adequately plead "a claim of entitlement to relief," dismissal is warranted. *Id.* at 558; *see Fischbein v. Olson Rsch. Grp., Inc.*, 959 F.3d 559, 561 (3d Cir. 2020) (on a motion to dismiss, "we disregard threadbare recitals of the elements of a cause of action, legal conclusions and conclusory statements").

B. All of Chatham's Claims Are Time-Barred

Apparent from the face of the Complaint, all of Chatham's claims are barred as a matter of law by the applicable two-year or three-year statute of limitations under Delaware law. Chatham claims that ACA provided allegedly incorrect advice pertaining to the Rebalancing Trades in March 2016, which affected Chatham's Rebalancing Trades executed between January 2016 through December 2018. Compl. ¶¶ 1, 3. According to Chatham, this allegedly incorrect advice led to the SEC's examination of Chatham's trading practices in June 2018, deficiency finding that the Rebalancing Trades were unlawful cross trades in May 2019, and initiation of a formal investigation later in 2019 resulting in the SEC Order. Chatham's claims thus accrued, at the latest, in 2019. *Id.* ¶¶ 3-7, 63, 66.

"A federal court sitting in diversity jurisdiction must apply the forum state's choice of law rules" to determine what law governs the substantive issues of a case, which includes statutes of limitations. *Maniscalco v. Brother Int'l Corp. (USA)*, 793 F. Supp. 2d 696, 704 (D.N.J. 2011); *Jaworowski v. Ciasulli*, 490 F.3d 331, 333 (3d

Cir. 2007). "New Jersey gives effect to contracting parties' private choice of law clauses unless they conflict with New Jersey public policy." *Gen. Motors Corp. v. New A.C. Chevrolet, Inc.*, 263 F.3d 296, 331 n.21 (3d Cir. 2001). Under the clear terms of the Non-Privileged Agreement and the Privileged Agreements, which governed ACA's compliance consulting services to Chatham, all of Chatham's claims are governed by Delaware law. Compl. at Exs. A and B §§ 8; *see also id.* at Ex. C § 2 (no modification of 2010 Privileged Agreement's choice of law clause).

Chatham's claims against ACA for breach of contract, gross negligence, negligent misrepresentation, and breach of fiduciary duty arise out of ACA's provision of services to Chatham under the parties' agreements. Each Count alleges that ACA failed to provide adequate compliance advice or conduct proper annual compliance reviews with respect to the Rebalancing Trades which resulted in the SEC's examination and investigation/enforcement proceeding in 2019. Both the Non-Privileged Agreement and the Privileged Agreements state that the purpose of the parties' engagement was to provide for an exchange of compliance consulting services from ACA to Chatham and that "[t]his Agreement shall be governed by, and construed in accordance with, the laws of the State of Delaware." Compl. at Exs. A and B §§ 8 p. 9.

Thus, regardless of the particular legal theory, Delaware law governs the claims, including the statute of limitations. *See Sullivan v. Sovereign Bancorp., Inc.*,

33 F. App'x 640, 642 (3d Cir. 2002) (affirming choice of law provision that was "broad and all-encompassing" to include tort claims); *Crescent Int'l, Inc. v. Avatar Cmtys., Inc.*, 857 F.2d 943, 944 (3d Cir. 1988) ("[P]leading alternate non-contractual theories is not alone enough to avoid a forum selection clause if the claims asserted arise out of the contractual relation and implicate the contract's terms.").

Under Delaware law, a two-year statute of limitations applies to gross negligence claims and a three-year statute of limitations applies to claims for breach of contract, negligent misrepresentation, and breach of fiduciary duty. *See* Crossey Decl. Ex. 3, *Cohen v. Miceli*, 2019 WL 1254010, at *7 (D. Del. Mar. 19, 2019) (citing 10 Del. C. § 8119) ("In Delaware, negligence and gross negligence claims are subject to a two-year limitations period."); *Weyerhaeuser Co. v. Domtar Corp.*, 61 F. Supp. 3d 445, 451 (D. Del. 2014) (citing 10 Del. C. § 8106(a)) (three-year statute of limitations for breach of contract claims); Crossey Decl. Ex. 4, *Homsey Architects, Inc. v. Nine Ninety Nine, LLC*, 2010 WL 2476298, at *8 (Del. Ch. June 14, 2010) (citing 10 Del. C. § 8106) (three-year statute of limitations for negligent misrepresentation); Crossey Decl. Ex. 5, *Swift v. Pandey*, 2014 WL 1366436, at *7 (D.N.J. Apr. 7, 2014) (citing 10 Del. C. § 8106) ("Delaware imposes a three-year statute of limitations for breach of fiduciary duty claims.").

When the basis for dismissal is a statute of limitations, it must be apparent from the face of the Complaint that the statute bars the claim. *Brody v. Hankin*, 145 Fed.

App'x 768, 771-72 (3d Cir. 2005). Here, because all of ACA's allegedly incorrect advice was given in 2019 or earlier and Chatham filed suit in 2023, all of Chatham's claims are time-barred on the face of the Complaint and should be dismissed.

C. Chatham Fails to State a Claim for Breach of Contract

Even if Chatham's claims were not time-barred (which they are), its Complaint also fails to state facts sufficient to support any claim against ACA, starting with breach of contract (Counts One and Two).

Under Delaware law, a plaintiff must plead three elements to state a breach of contract claim: (1) existence of a contract, (2) breach of a contractual obligation, and (3) resulting damages. *VLIW Tech., LLC v. Hewlett-Packard Co.*, 840 A.2d 606, 612 (Del. 2003); *Wal-Mart Stores, Inc. v. AIG Life Ins. Co.*, 901 A.2d 106, 116 (Del. 2006) (Delaware law requires a plaintiff to identify an "express contract provision that was breached" in order to state a contract claim). Here, Chatham fails to plead the second element. It does not identify *any* specific contractual provision that ACA is alleged to have violated. Courts applying Delaware law routinely dismiss contract claims that fail to specify the obligation allegedly breached. *See Wal-Mart*, 901 A.2d at 116 (dismissing contract claim); *see also, e.g.*, *Anderson v. Wachovia Mortg. Corp.*, 621 F.3d 261, 279-80 (3d Cir. 2010) (affirming dismissal of breach of contract claim for failure to identify "any express contract provision that was breached"); Crossey Decl. Ex. 6, *Zazzali v. Alexander Partners, LLC*, 2013 WL

5416871, at *12 (D. Del. Sept. 25, 2013) (dismissing breach of contract claim where plaintiff "failed to identify an actual contractual obligation … to which the defendants were subject").

Chatham's claims for breach of contract rely entirely on the conclusory allegations that ACA breached the two Agreements by failing to "provide Chatham with accurate compliance advice," "conduct the required compliance reviews in accordance with the applicable regulatory requirements," and "provide support during Chatham's SEC Examination." Compl. ¶¶ 72, 77. These allegations do not identify any contractual obligation that ACA breached. This is mere argument that ACA must have breached the Agreements because the SEC determined, after its own extensive investigation, that certain Rebalancing Trades were unlawful. However, Chatham fails to point to any provision of the contracts that required ACA to give advice that would be bullet-proof against the SEC.

Indeed, to the contrary, the parties expressly recognized in these contracts that ACA did not assume the risk of adverse SEC action. The parties agreed that ACA's services were "designed to help provide reasonable, but not absolute, assurance" that Chatham "has, or will have, an adequate and effective compliance program" and that "ACA will not perform a detailed inspection of all of [Chatham's] books and records and transactions." Compl. at Exs. A and B § 2. The parties also explicitly acknowledged that "there was a risk that material issues or deficiencies [or]

violations of law … will not be detected during the course of this engagement." *Id.* Additionally, the parties agreed that it was Chatham's responsibility to ensure the records and information it provided to ACA were accurate and complete, and that ACA did not bear the risk of Chatham's non-compliance. *Id.* at § 5. Because Chatham fails to identify or allege any actual contractual duty that ACA breached, the breach of contract claims fail as a matter of law on the face of the Complaint.

Moreover, even if Chatham could identify an actual contractual obligation ACA breached (which it cannot), it still fails to state a cause of action against ACA because Chatham has not sufficiently alleged damages resulting from ACA's conduct. Other than the conclusory statement that "Chatham has suffered substantial injuries and damages," nowhere in the Complaint are there facts plausibly alleging that Chatham suffered any damages *as a result* of ACA's alleged breach of the two Agreements. Compl. ¶¶ 73, 78 and Wherefore Clause. These omissions are fatal to a claim for breach of contract. *See, e.g.*, Crossey Decl. Ex. 7, *UtiliSave, LLC v. Miele*, 2015 WL 5458960, at *10 (Del. Ch. Sept. 17, 2015) (dismissing breach of contract claim because the plaintiff "failed ... to plead facts supporting a reasonable inference that [the defendant]'s breach caused the [plaintiff] economic harm"). With no damages resulting from any alleged breach, Chatham's breach of contract claims fail.

Accordingly, because the Complaint fails to adequately allege a breach of any provisions of the parties' contracts or any legally cognizable harms as a result thereof, Chatham's breach of contract claims should be dismissed.

D. Chatham Fails to State Any Actionable Tort Claim

Likewise, Chatham's alleged tort claims for gross negligence, negligent misrepresentation, and breach of fiduciary duty are deficient on the face of the Complaint (Counts Three, Four and Five). The claims are barred as a matter of law by the economic loss doctrine and, in any event, fail to state facts sufficient to allege gross negligence, which is required for ACA to have any liability under the contracts.

1. Chatham's Tort Claims are Barred by the Economic Loss Doctrine

Chatham's tort claims are barred by the economic loss doctrine, adopted in Delaware, which "prohibits a party from recovering in tort economic losses, the entitlement of which, flows only from a contract." *Sea Star Line, LLC v. Emerald Equip. Leasing, Inc.*, 2006 WL 214206, at *9 (D. Del. Jan. 26, 2006) (Crossey Decl. Ex. 8). When a duty one party owes to another is based *only* on a contract, and "not on a violation of an independent duty imposed by law," the economic loss doctrine bars tort claims. *Id.*

All of Chatham's tort claims are expressly predicated on ACA's alleged breaches of its obligations under the Non-Privileged Agreement and the Privileged Agreements and seek the same economic damages. *See, e.g.*, *Compl.* ¶¶ 2, 4, 13.c.,

16, 80, 83, 91, 93, 101(g.-h.), Wherefore Clause (alleging that ACA breached its duties under the parties' agreements in the same ways and seeking the same damages for all counts); *see also* Crossey Decl. Ex. 9, *Khushaim v. Tullow Inc.*, 2016 WL 3594752, at *7 n.65 (Del. Super. Ct. June 27, 2016) (holding that the economic loss doctrine applies where the conduct alleged in tort claims is identical to the conduct alleged in a breach of contract claim).

First, Chatham's gross negligence claim relies entirely on Chatham's breach of contract claims: "ACA owed Chatham a duty of reasonable care in connection with the services and advice ACA provided … under the agreements between both parties." Compl. ¶ 80; *compare id.* ¶¶ 72, 77 (breach of contract allegations), *with* ¶ 83 (gross negligence allegations). But "[merely] charging a breach of a duty of due care, employing language familiar to tort law, does not, without more, transform a simple breach of contract into a tort claim." *Hatzel & Buehler, Inc. v. Orange & Rockland Utilities, Inc.*, 1992 WL 391154, at *12 n.15 (D. Del. Dec. 14, 1992) (Crossey Decl. Ex. 10). Thus, Chatham's gross negligence claim is merely duplicative of its breach of contract claims and should be dismissed. *See* Crossey Decl. Ex. 11, *Genesis FS Card Servs., Inc. v. Lenovo (United States), Inc.*, 2023 WL 2563159, at *7 (D. Del. Mar. 17, 2023) (dismissing gross negligence claim under the economic loss doctrine).

Second, likewise, Chatham's negligent misrepresentation claim is based upon contractual duties, and, therefore, also must be dismissed under the economic loss doctrine as duplicative. *Compare* Compl. ¶¶ 72, 77 (breach of contract allegations) *with* ¶ 91 (negligent misrepresentation allegations) and ¶ 93 (relying on duties created by the "Non-Privileged and Privileged Agreements"); *see* Crossey Decl. Ex. 12, *Delaware Art Museum v. Ann Beha Architects, Inc.*, 2007 WL 2601472, at *3 (D. Del. Sept. 11, 2007) (dismissing negligent misrepresentation claim on basis of economic loss doctrine); *see also Madison Cap. Co., LLC v. Alasia, LLC*, 615 F.Supp.2d 233, 240 (S.D.N.Y. 2009) ("If the duty between the parties arose out of a contract, such that the contract required a correct representation, then any misrepresentation must be pled as a breach of contract, not as a tort claim for negligent misrepresentation.").

Finally, Chatham's fiduciary duty claim again precisely tracks its breach of contract claim. *Compare* Compl. ¶¶ 72, 77 (breach of contract allegations) *with* ¶ 101(g.-h.) (breach of fiduciary duty allegations). In addition, Chatham simply ignores the parties' express contractual disclaimer of having any fiduciary duty to each other, and does not even attempt to allege a common law basis for any such duty. Thus, the breach of fiduciary duty claim is duplicative of (and expressly in conflict with) the breach of contract claims and should be dismissed. *See* Crossey Decl. Ex. 13, *Glenz v. RCI, LLC*, 2010 WL 323327, at *5 (D.N.J. Jan. 20, 2010) (dismissing breach of fiduciary duty claim on basis of economic loss doctrine).

2. Chatham Fails to Plead Facts Sufficient to State Any Tort Claim

In addition to the fatally dispositive time bar and economic loss doctrine, Chatham fails in any event to plead facts sufficient to state a claim for gross negligence, negligent misrepresentation, or breach of fiduciary duty.

a) Count Three Fails to Allege Gross Negligence

Chatham relies entirely on conclusory allegations that ACA was "reckless" and "grossly negligent" in providing advice regarding the Rebalancing Trades and/or failing to identify certain Rebalancing Trades as potential illegal cross-trades in annual compliance reviews. *See* Compl. ¶¶ 83-84, 87. Viewed most favorably to Chatham, the factual allegations do not even support an inference of simple negligence (which ACA denies), which would be barred in any event by the limitation of liability clauses in the Non-Privileged Agreement and the Privileged Agreements. Compl. at Exs. A-B §§ 5. For the purposes of a motion to dismiss, the Court may ignore Chatham's mere legal conclusions. Setting those aside, there is no factual basis for Chatham's gross negligence claim.

In order to state a claim for gross negligence under Delaware law, a plaintiff must allege that the defendant's "negligent act or omission breached a duty of care owed to the plaintiff in a way that proximately caused the plaintiff's injuries." *Drummond v. Delaware Transit Corp.*, 365 F. Supp. 2d 581, 585 (D. Del. 2005).

The plaintiff must also plead that the defendant's behavior demonstrated "a higher level of negligence representing 'an extreme departure from the ordinary standard of care.'" *Browne v. Robb*, 583 A.2d 949, 953 (Del. 1990). Gross negligence requires a finding that a defendant was "deliberately indifferent to a known or obvious risk." *Waters v. Dep't of Pub. Safety*, 2020 WL 4501945, at *10 (D. Del. Aug. 5, 2020) (Crossey Decl. Ex. 14).

Chatham does not plead any specific facts or actions that would support an inference that ACA's alleged service deficiencies rose to the level of gross negligence or proximately caused Chatham's alleged damages. Instead, Chatham simply argues that ACA must have been grossly negligent because the SEC later determined that certain trades were unlawful. Such conclusory allegations are insufficient to state a claim for gross negligence. Chatham's bald statements that ACA's conduct was "reckless," "wanton," and "grossly negligent" are precisely the types of legal conclusions couched as factual allegations that *Twombly* does not require courts to accept as true. 550 U.S. at 555. Chatham's gross negligence claim should be dismissed.

b) Count Four Fails to Allege Negligent Misrepresentation

Chatham's negligent misrepresentation claim likewise rests on conclusory contentions, unsupported by alleged facts. Chatham contends that ACA "made incorrect statements, misrepresentations and/or concealed or failed to disclose

material facts about … Chatham's compliance with SEC rules and regulations and the Rebalancing Trades." Compl. ¶ 91. Chatham concludes that ACA made "incorrect, false and/or misleading statements … to Chatham orally and in writing" and that ACA was aware that its advice … would be and actually was … relied up [*sic*] by Chatham." *Id.* These contentions and conclusions do not state a claim.

To state a claim for negligent misrepresentation under Delaware law, a plaintiff must allege: (1) "a particular duty to provide accurate information, based on the plaintiff['s] pecuniary interest in that information;" (2) "the supplying of false information;" (3) "failure to exercise reasonable care in obtaining or communicating information; and" (4) "a pecuniary loss caused by justifiable reliance on the false information." *H-M Wexford LLC v. Encorp, Inc.*, 832 A.2d 129, 147 n.44 (Del. Ch. 2003). A plaintiff must allege sufficient facts on each element of the negligent misrepresentation claim to sustain the claim. *See, e.g.*, Crossey Decl. Ex. 15, *Panella v. O'Brien*, 2006 WL 2466858, at *8 (D.N.J. Aug. 24, 2006) (dismissing negligent misrepresentation claim where plaintiff "failed to plead justifiable reliance with the requisite particularity"); *Floyd v. Brown & Williamson Tobacco Corp.*, 159 F. Supp. 2d 823, 834 (E.D. Pa. 2001) (dismissing negligent misrepresentation claim that "contain[ed] no allegations whatsoever concerning specific negligent misrepresentations").

Chatham's allegations fall short on every element. The only *representation* by ACA alleged in the Complaint is the advice allegedly given by an ACA partner in March 2016 to a Chatham executive in response to an inquiry about rebalancing trades. Compl. ¶ 31. Chatham gives no context to the conversation and no indication that Chatham provided any specifics to ACA. Chatham has not and cannot plead that ACA ever knew specific facts found by the SEC – *i.e.*, that Chatham was engaging in pre-arranged trades with brokers for pre-arranged prices. *See id.* ¶¶ 3, 31, 37-38, 91. There is no factual allegation that ACA's 2016 advice was tailored in any way to the Rebalancing Trades at issue (*i.e.*, there is no mention of AMI bonds or LAFs). Nor did Chatham rely on the advice because Chatham engaged in pre-arranged, non-market trades. There is no allegation, nor could there be, that ACA ever advised Chatham to engage in pre-arranged trades, or represented that pre-arranged trades were lawful.

In short, Chatham has failed to plead facts that, if true, support the allegations that ACA made any misrepresentation of fact to Chatham, failed to exercise reasonable care in making the representation, or that Chatham justifiably relied upon the representation. Moreover, negligent misrepresentation—even if alleged—is not "gross negligence," which is the contractual threshold standard of conduct for which ACA could even be liable to Chatham. Compl. at Exs. A-B §§ 5. Chatham's improper

attempt to circumvent that threshold based on patently deficient, conclusory allegations should be rejected and its negligent misrepresentation claim dismissed.

c) Count Five Fails to Allege Breach of Fiduciary Duty

Chatham's claim for breach of fiduciary duty also fails as a matter of common law and contract: there was no fiduciary relationship between the parties. Under Delaware law, a breach of fiduciary duty claim requires the plaintiff to plead that: (1) a fiduciary duty exists between the parties; and (2) a fiduciary breached that duty. *Dynamis Therapeutics, Inc. v. Alberto-Culver Int'l, Inc.*, 2010 WL 3834405, at * 3 (D. Del. Sept. 22, 2010) (Crossey Decl. Ex. 16). Chatham fails to plead the first element. While Chatham focuses on the alleged *breach* of fiduciary duty (which ACA disputes), it provides ***zero facts*** to meet the threshold requirement to show that a fiduciary duty even existed between the parties. Chatham merely contends that ACA "was acting in a fiduciary capacity." Compl. ¶ 99. This is not enough. Chatham's breach of fiduciary claim should be dismissed for two reasons.

First, the Non-Privileged Agreement and the Privileged Agreements expressly disclaimed the existence of a fiduciary relationship between ACA and Chatham and provided that these parties would have the arm's length relationship of independent contractors. *See* Compl. at Ex. B § 2 ("[E]ach party shall act as an independent contractor to the other …. Nothing herein shall be deemed or construed to create a … fiduciary relationship between ACA and [Seward & Kissel], or between ACA

and [Chatham], for any purpose."), and Ex. A § 2 (virtually identical language except that the contract was between only Chatham and ACA, not Seward & Kissel); *see also* Compl. at Ex. C § 2 (incorporating the above language in Ex. B). Such explicit contractual waivers of fiduciary relationships are enforceable under Delaware law. *See, e.g.*, *Dynamis*, 2010 WL 3834405, at *4 (dismissing breach of fiduciary duty claim on motion to dismiss and holding that where a contract clearly and unambiguously disclaimed a fiduciary relationship, no fiduciary relationship existed as a matter of law).

Second, no fiduciary relationship existed between Chatham and ACA under the common law. The Non-Privileged Agreement and the Privileged Agreements were arm's length transactions between sophisticated parties, and Delaware law refuses generally to infer a fiduciary relationship from such a garden variety commercial relationship. *Wal-Mart Stores, Inc. v. AIG Life Ins. Co.*, 872 A.2d 611, 626 (Del. Ch. 2005) (dismissing breach of fiduciary duty claims, finding Wal-Mart alleged "no facts from which the court could infer that the relationship was anything but an arm's length business relationship"). Chatham utterly fails to allege any special circumstances from which a fiduciary duty may be implied. Instead, in the most conclusory fashion, Chatham simply asserts that ACA "held itself out as an expert in compliance" and was "acting in a fiduciary capacity." Compl. ¶ 99. A party "cannot show the existence of a fiduciary relationship by alleging simply that it

relied on or 'trusted in' the assurances and expertise of [the other party]." *Wal-Mart*, 872 A.2d at 628 (explaining that a party must allege that there was something more to the relationship between the parties, including an alignment of interests, an exertion of control or dominion, or self-dealing). Chatham's claim for breach of fiduciary duty exhibits precisely the type of insufficient pleading by formulaic recitation of labels condemned by *Twombly*.

IV. CONCLUSION

For the foregoing reasons, ACA respectfully requests that this Court grant its motion and dismiss Chatham's Complaint with prejudice for failure to state a claim pursuant to Rule 12(b)(6).

Respectfully submitted,

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Dated: June 7, 2023

/s/ Nicole E. Crossey
Nicole E. Crossey