

**UNITED STATES DISTRICT COURT  
FOR THE SOUTHERN DISTRICT OF NEW YORK**

WILLIAM T. ESREY AND RONALD T. LEMAY	)	
	)	
	)	
Plaintiffs,	)	
v.	)	
	)	Civil Case No.: 1:16-cv-03019
THE UNITED STATES OF AMERICA	)	
	)	
Defendant.	)	<b>COMPLAINT</b>
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**INTRODUCTION**

1. In 2002, the Internal Revenue Service (“IRS”) Criminal Investigation Division (“CID”) and the United States Attorney’s Office for the Southern District of New York (“SDNY”) began to investigate the promotion of tax shelters by Ernst & Young LLP (“EY”) to its clients. The IRS also began a civil audit of EY’s promotion of tax shelters to those same clients.

2. EY’s clients who had been sold these tax shelters included plaintiffs William T. Esrey (“Esrey”) and Ronald T. LeMay (“LeMay”) (collectively, the “Plaintiffs”). At the time, Esrey was the Chief Executive Officer (“CEO”) of Sprint Corporation (“Sprint”), and LeMay was Sprint’s Chief Operating Officer (“COO”). In addition to the criminal and civil investigations of EY’s conduct, the IRS began audits of Esrey and LeMay in the 2002 timeframe.

3. EY knew during 2002 and 2003 that its conduct was under investigation by SDNY, CID, and/or IRS. These investigations created a conflict of interest between EY and the Plaintiffs.

4. In July 2003, EY settled the civil audit of its tax shelter promotion activities for \$15 million, which – unbeknownst to Esrey and LeMay at the time – included a \$1.4 million additional payment to induce the IRS not to call the \$15 million a “penalty” in the IRS press release.

5. EY withheld material information from Esrey and LeMay about the civil and criminal investigations of EY and EY’s agreement to resolve the IRS tax shelter promoter audit. As their long-standing tax advisor, EY owed the Plaintiffs fiduciary duties, including duties of candor, loyalty, and performance. Instead, EY represented to Plaintiffs that it would be able to favorably settle their individual audits and did not disclose the extent or seriousness of the investigations into its conduct. Plaintiffs reasonably relied on EY’s representations and advice and trusted that it was telling them the truth. Likewise, Plaintiffs relayed these representations to their employer, Sprint.

6. The IRS knew of EY’s fiduciary duties to Plaintiffs, and of EY’s conflict of interest, but nonetheless helped EY to hide information from Plaintiffs knowing that such information would have been critical to Plaintiffs’ evaluation of whether to trust EY and whether to continue to tell Sprint that EY was trustworthy and devoted to helping Plaintiffs resolve their tax audits with the IRS. The IRS also permitted EY to continue to represent Plaintiffs before the IRS, notwithstanding that this continued representation violated Treasury Department Circular No. 230, 31 C.F.R. §§ 10.0-10.93 (2003).

7. As a result of EY's breach of fiduciary duty and of the IRS's active concealment of the criminal investigation and the truth about the tax shelter promoter audit, Esrey and LeMay could not defend themselves against allegations by Sprint and Sprint shareholders regarding their participation in the EY-promoted transactions. For instance, Plaintiffs were unable to tell Sprint that EY's tax shelter promotion activities were being criminally investigated. Instead, the blame for the tax shelters fell on Plaintiffs and they were ultimately forced to resign from Sprint in 2003.

### **JURISDICTION AND VENUE**

8. This action arises under the Federal Tort Claims Act, 28 U.S.C. §§ 2671-80. This Court has jurisdiction over this case pursuant to 28 U.S.C. §§ 1346(b)(1) and 2674.

9. Venue is proper in this district pursuant to 28 U.S.C. §§ 1391(e) and 1402(b).

### **THE PARTIES**

10. Plaintiff William T. Esrey is an individual with his residence at 1314 Spraddle Creek Road, Vail, CO 81657. Plaintiff Ronald T. LeMay is an individual with his residence at 1214 West 55th Street, Kansas City, MO 64112.

11. Defendant is the United States of America.

### **BACKGROUND**

#### **A. EY's Fiduciary Relationship with the Plaintiffs.**

12. Esrey was employed by Sprint from 1980 through 2003. Esrey was Sprint's CEO from 1985 through 2003 and Sprint's Chairman from 1990 to 2003.

13. LeMay was employed by Sprint from 1985 through 2003. LeMay was Sprint's President and Chief Operating Officer from 1996 to 2003, except for a period of approximately one hundred days during which Mr. LeMay left Sprint to serve as Chairman and Chief Executive Officer of Waste Management, Inc.

14. EY is a global accounting firm and one of the largest accounting firms operating in the United States.

15. EY had been Esrey's tax advisor and financial planner for over two decades as of 2002. EY had been LeMay's tax advisor and financial planner for over one decade as of 2002.

16. EY was in a fiduciary relationship with Esrey and LeMay. That fiduciary relationship included the duty of candor, the duty of loyalty, the duty of performance, and the duty to act in the best interests of Esrey and LeMay.

17. During the time that Esrey and LeMay were employed by Sprint, EY was Sprint's certified public accountant.

18. On the advice of EY, Esrey and LeMay engaged in two transactions promoted by EY, the Contingent Deferred Swap ("CDS") transaction in 1999 and 2000 and the CDS Add-On ("Add-On") transaction in 2000 and 2001.

**B. The IRS Investigations of EY.**

19. The IRS initiated an audit of EY's promotion of certain tax shelters (the "Promoter Audit") in March 2002.

20. IRS employees conducting the Promoter Audit worked at an IRS office located in New York, New York.

21. During 2002, the IRS also began to audit taxpayers who had participated in tax shelters promoted by EY, including entities owned by Esrey and LeMay (the “Investor Audits”). IRS employees located in New York, NY worked on the Investor Audits.

22. EY represented Esrey and LeMay before the IRS in connection with the Investor Audits.

23. The IRS dealt directly with EY as representatives of Esrey and LeMay during the Investor Audits.

24. On June 21, 2002, the United States Attorney’s Office for the SDNY informed EY that it was initiating an investigation into EY’s conduct in promoting tax shelters.

25. At that time, EY retained Gerald Feffer (“Feffer”), an esteemed criminal tax lawyer with the law firm of Williams & Connolly.

26. On June 24, 2002, EY’s General Counsel, Kathryn Oberly (“Oberly”), informed certain EY employees of the investigation and placed a litigation hold on all materials related to EY’s promotion of tax shelter transactions (the “Litigation Hold”).

27. On June 28, 2002, Shirah Neiman (“Neiman”), a senior Assistant U.S. Attorney at SDNY, contacted Oberly about the investigation. Neiman requested, among other things, a letter confirming that EY had placed a litigation hold on relevant documents and information about the criminal statute of limitations.

28. On July 2, 2002, Feffer faxed to Neiman a copy of the Litigation Hold pursuant to Neiman’s June 28 request.

29. Prior to this litigation hold being put into place, EY personnel had already destroyed documents relating to EY’s tax shelter activities.

30. On July 9, 2002, Neiman informed EY's criminal counsel that the IRS had declined to authorize the opening of a grand jury proceeding at that time, but that her office would continue to monitor the matter. The Litigation Hold was never lifted.

31. Throughout 2003, the IRS CID pursued a criminal investigation of EY's conduct in promoting tax shelters.

32. In June 2003, IRS agents involved in the EY Promoter Audit told EY that CID was investigating the conduct of certain EY employees and that the Promoter Audit team was sharing documents with CID.

33. EY agreed in concept to settle the Promoter Audit with the IRS for approximately \$13 million.

34. During June 2003, EY and the IRS negotiated over use of the term "penalty" in the IRS press release announcing the settlement of the Promoter Audit. The IRS initially insisted that the word "penalty" be used to accurately describe the settlement payment in the IRS press release. EY told the IRS it was concerned that the fact it paid a penalty would be "discovered by clients" and used in litigation against EY. At least one in-person settlement meeting between EY and the IRS took place in New York.

35. Although the IRS's initial position was that use of the term "penalty" was not negotiable, the IRS changed its position and agreed to remove the term "penalty" from the press release if EY would "sweeten the deal."

36. On July 2, 2003, EY and the IRS settled the Promoter Audit. EY paid the IRS a \$15 million penalty, which included a \$1.4 million increase in the payment in exchange for the IRS's agreement not to call that payment a "penalty" in the press release announcing the

settlement. The IRS knowingly induced or participated in EY's breach of fiduciary duty when it helped EY conceal the true nature of its settlement payment.

37. By May 2004, SDNY had initiated a federal grand jury investigation of EY's sale of tax shelters. On May 19, 2004, Justin Weddle, Assistant United States Attorney at SDNY, called EY's criminal counsel and informed him that SDNY was formally investigating EY's tax shelter activities.

38. On May 24, 2004, newspapers reported that EY was under grand jury investigation for its tax shelter activities.

39. In May 2007, the grand jury indicted four EY employees for participating in a scheme to defraud the IRS by designing, marketing, implementing, and defending fraudulent tax shelters.

40. On May 8, 2009, the four EY employees were convicted of multiple charges, including tax evasion in connection with the tax shelters.<sup>1</sup> The Second Circuit affirmed two of the convictions and reversed the other two convictions.<sup>2</sup>

41. On February 28, 2013, EY entered into a non-prosecution agreement with SDNY, pursuant to which EY agreed to pay \$123 million.

42. On March 1, 2013, SDNY issued a press release relating to the non-prosecution agreement touting EY's cooperation with the government investigation into the tax shelters since approximately 2003, during the time the IRS was helping EY conceal its conflict of interest from Plaintiffs.

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<sup>1</sup> United States v. Coplan, Dkt. No. 1:07-cr-00453-SHS (S.D.N.Y. May 7, 2009).

<sup>2</sup> United States v. Coplan, 703 F.3d 46 (2d Cir. 2012).

**C. EY's Breach of Fiduciary Duty.**

43. EY was on notice from June 2002 that its conduct in promoting tax shelters had attracted the attention of federal prosecutors.

44. In June 2003, the IRS explicitly informed EY that a criminal investigation of EY's conduct, including the conduct of its employees and partners, was ongoing.

45. Larry D. Thompson, Deputy Attorney General, released a memo titled "Principles of Federal Prosecution of Business Organizations" (the "Thompson Memo") on January 20, 2003. One factor identified in the Thompson Memo to be considered in Department of Justice charging decisions is the organization's "willingness to cooperate." The Thompson memo states that organizational immunity or amnesty may be granted in exchange for cooperation.

46. As a result of the IRS criminal investigation of EY's conduct in promoting tax shelters, EY's interests conflicted with those of Esrey and LeMay.

47. EY did not tell Esrey or LeMay about the criminal investigation or its conflict of interest.

48. EY represented Esrey and LeMay before the IRS during the time it had an undisclosed conflict of interest associated with the criminal and promoter investigations.

49. Esrey and LeMay did not know about the IRS criminal investigation until the May 25, 2004 public disclosure of that investigation.

50. Prior to May 25, 2004, when the Wall Street Journal published an article about the criminal investigation of EY, Esrey and LeMay believed that EY continued to act in their best interests. Esrey and LeMay believed that their interests were aligned with EY's interests, in that Esrey, LeMay, and EY all had the same objectives to prevail against the IRS in the Investor Audits.

51. The IRS knew that EY was aware of the criminal investigation and that EY's interests conflicted with its tax shelter clients that it was representing before the IRS, including Esrey and LeMay.

52. It was IRS policy during 2002 to seek assurances from taxpayer representatives who were tax shelter promoters that their clients were informed of potential conflicts of interest. Internal Revenue Manual part 35.3.12.10 (rev. 5-9-06); NSAR 020331 (Sept. 10, 2002) ("The Manual requires the Service to seek assurances from the POA that the investors have been informed of the potential conflict of interest situation to protect the integrity of the settlement and litigation process.").

53. The IRS permitted EY to continue to represent Esrey and LeMay before the IRS, including before IRS employees working in New York, NY.

54. Plaintiffs filed petitions in the Tax Court in 2008 challenging Final Partnership Administrative Adjustments that were issued by the IRS on January 31, 2008 (the "Tax Court Case").

55. Throughout the Tax Court Case, the IRS failed to disclose information relevant to the case, contrary to its discovery obligations and court order. Instead, the IRS repeatedly represented that documents were destroyed or did not exist, only to locate portions (but not all) of those documents at a later time when faced with sanctions or when additional information was revealed.

56. Pursuant to discovery in the Tax Court Case, on August 21, 2013, five days before trial, the IRS produced to Plaintiffs documents showing that EY told the IRS it was concerned that the fact it paid a penalty would be "discovered by clients" and that the IRS enabled EY to hide this information in exchange for a "sweetener" of \$1.4 million. This was the first time

Plaintiffs learned of the IRS's active enabling of EY's breaches of its fiduciary duties to Esrey and LeMay.

57. Plaintiffs initiated an arbitration action against EY on September 15, 2011 (the "Arbitration"). On November 11, 2013, the Arbitration panel issued an interim award in favor of Esrey and LeMay; a final award was made on February 17, 2014. Plaintiffs incurred attorneys and expert fees and expenses relating to the Arbitration action. The delay in Plaintiffs learning of the extent of EY's breaches of its fiduciary duties increased their Arbitration costs.

### **INJURY TO PLAINTIFFS**

58. On February 26, 2001, Sprint entered into new employment agreements with both Esrey and LeMay. The Sprint Board authorized the contracts with full knowledge that Plaintiffs had entered into the transactions that EY had promoted.

59. LeMay was Esrey's likely successor as CEO of Sprint. The Board informed LeMay of that fact in writing on October 2, 2002.

60. The Sprint Board and the Sprint Audit Committee became concerned that there could be a conflict of interest between Esrey and EY and LeMay and EY because of the IRS audits of Esrey and LeMay. Beginning in 2002, Sprint required Esrey and LeMay to certify every quarter that they had no present intention to sue EY.

61. In December 2002, Esrey and LeMay made a presentation to the Sprint Board recommending that Sprint dismiss EY as its auditor because of the Sprint Board's and Sprint Audit Committee's concern that there could be a conflict of interest between Esrey and LeMay and EY. At the same time, EY met with the Sprint Board and represented that its advice to Esrey

and LeMay was sound and its actions proper. This was at a time when EY knew that same advice and those same actions were under criminal investigation.

62. In December 2002, neither Esrey nor LeMay knew of the criminal investigation of EY.

63. The Sprint Board determined that the potential conflict of interest was too great, and concluded that firing its auditor would result in negative publicity and would negatively impact Sprint.

64. The Sprint Board asked both Esrey and LeMay to resign from their positions at Sprint.

65. LeMay and Esrey left Sprint in April and May 2003, respectively.

66. EY remained Sprint's auditor until October 2003.

#### **THE IRS'S DENIAL OF PLAINTIFFS' ADMINISTRATIVE CLAIMS**

67. Pursuant to 28 U.S.C. § 2675(a), Esrey presented the IRS with the claim set forth herein on April 29, 2015.

68. On October 22, 2015, the IRS denied the Esrey FTCA Claim.

69. Pursuant to 28 U.S.C. § 2675(a), LeMay presented the IRS with the claim set forth herein on April 29, 2015.

70. On October 22, 2015, the IRS denied LeMay's claim.

#### **CAUSE OF ACTION (AIDING AND ABETTING A BREACH OF FIDUCIARY DUTY)**

71. All preceding allegations are incorporated here as if set forth in full.

72. EY breached its fiduciary duties of loyalty and performance to Plaintiffs.

73. The Defendant knowingly participated in EY's breaches of its fiduciary duties to Plaintiffs in violation of the laws of New York.

74. Plaintiffs exhausted their administrative remedies with regard to their claims against the Defendant.

**PRAYER FOR RELIEF**

WHEREFORE, Esrey and LeMay demand judgment against Defendant in the sums of \$42,550,000 and \$116,800,000, respectively, fees and costs, and such other relief as the Court deems appropriate.

**Dated: April 22, 2016**

Respectfully submitted,

s/ Daniel A Rosen  
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(Motion for Admission Pro Hac Vice Pending)  
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## General Information

<b>Court</b>	United States District Court for the Southern District of New York; United States District Court for the Southern District of New York
<b>Federal Nature of Suit</b>	Personal Property - Other Property Damage[380]
<b>Docket Number</b>	1:16-cv-03019