No. 04-

**IN THE UNITED STATES COURT OF APPEALS**
**FOR THE SECOND CIRCUIT**

---

TEACHERS' RETIREMENT SYSTEM
OF LOUISIANA, ET AL.,

Plaintiffs-Respondents,

v.

ACLN LTD., ET AL.,

Defendants,

BDO SEIDMAN, LLP,

Defendant-Applicant.

---

# APPLICATION OF BDO SEIDMAN, LLP, FOR PERMISSION TO APPEAL PURSUANT TO FEDERAL RULE OF CIVIL PROCEDURE 23(f)

---

From an Order Granting Certification of a Class Action Against
Defendant-Applicant BDO Seidman, LLP, Entered May 18, 2004,
by the United States District Court for the Southern District of New York,
Case No. 01-CV-11814 (MP)
The Honorable Milton Pollack


BDO SEIDMAN, LLP
Barbara Taylor
330 Madison Avenue
New York, NY 10017

ROBBINS, RUSSELL, ENGLERT,
ORSECK & UNTEREINER LLP
Gary A. Orseck
Lawrence S. Robbins
Roy T. Englert, Jr.
Kathryn S. Zecca
Brian M. Willen
1801 K Street, NW, Suite 411
Washington, D.C. 20006
(202) 775-4500


June 1, 2004

*Attorneys for BDO Seidman, LLP*

## TABLE OF CONTENTS

**Page**

## TABLE OF AUTHORITIES

**Page(s)**

**Cases:**



**Statutes and Regulations:**

**Miscellaneous:**

Defendant-Petitioner BDO Seidman, LLP ("Seidman") respectfully applies under Federal Rule of Civil Procedure 23(f) for permission to appeal from a May 18, 2004 order of the United States District Court for the Southern District of New York certifying a class against Seidman under Rule 23(b)(3).

## QUESTION PRESENTED

In *Wright* v. *Ernst & Young LLP*, 152 F.3d 169, 175 (2d Cir. 1998), this Court held that, to satisfy the reliance requirement of Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b), a securities fraud plaintiff must show the existence of an allegedly misleading statement that was "attributed to" the defendant "at the time of public dissemination, that is, in advance of the investment decision." This application presents the question whether the "fraud-on-the-market" doctrine of *Basic Inc.* v. *Levinson*, 485 U.S. 224 (1988), entitles a plaintiff to class certification based upon a presumption of reliance on audit opinions that do not name the defendant and that could have been attributed to the defendant only through a convoluted series of inferences based on various pieces of inconclusive circumstantial information.

## INTRODUCTION

On May 18, 2004, the district court ordered this securities fraud case to proceed as a class action against Seidman. Yet no motion to certify plaintiffs' action against Seidman as a class action was ever filed; and *none* of the findings required by FED. R. CIV. P. 23(b)(3) has ever been made with respect to plaintiffs' action against Seidman. Indeed, when Seidman sought to have Judge Pollack actually address the critical Rule 23(b)(3) issue whether common questions predominate over individual questions, he still did not address that issue, but instead relied on his own prior ruling in this case *denying Seidman's motions to dismiss*. Whether the complaint states a claim, of course, is not at all the same as whether common issues predominate. Yet Seidman now faces a

class action without *any* judicial answer to the latter question. Furthermore, in the circumstances of this case – in which each plaintiff's reliance on Seidman's supposed connection to allegedly misleading audit reports is an individualized question of fact – the predominance question cries out not just for judicial resolution, but for prompt *appellate* resolution.

The unusual procedural history by which this case reached this stage will be discussed below, but the substance of the matter is that the district court applied the fraud-on-the-market presumption in a "novel context" without identifying a persuasive "causal link" between Seidman's role in the alleged fraud and the price of the stock purchased by plaintiffs. *Hevesi* v. *Citigroup Inc.*, 366 F.3d 70, 78-79 (2d Cir. 2004). In so doing, Judge Pollack conducted nothing like the "rigorous analysis" required by Rule 23. *General Tel. Co.* v. *Falcon*, 457 U.S. 147, 161 (1982). Rule 23(f) exists to allow for the correction of just such lawless class certification decisions, which (given the realities of this kind of high-stakes class action litigation) are likely not otherwise to face appellate scrutiny. The fraud-on-the-market doctrine entitles plaintiffs to a presumption of reliance – an indispensable element a Section 10(b) claim – if "common sense and probability" (*Basic*, 485 U.S. at 246) indicate both that the *market* relied on a defendant's alleged misstatement and that individual class members in turn relied on the integrity of the market. If it is *not* reasonable to suppose that the market relied on the defendant's misstatement, the presumption does not apply and each plaintiff must prove reliance individually. In that event, common questions generally do *not* predominate, and class certification is improper. *Id*. at 242.

In a typical Section 10(b) case against an independent auditor, plaintiffs will point to one or more alleged misstatements – usually contained within an audit opinion – that were clearly identified as statements *made by that auditor*. The identity of the auditor is reflected on the face of the

opinion, allowing the market readily to attribute the statement to the auditor and thus to rely on the auditor's imprimatur – and professional reputation – in setting the price of the issuer's stock.

Plaintiffs' case against Seidman is quite different. The two audit opinions containing the allegedly false statements both expressly say that they were issued by "BDO International, Nicosia, Cyprus" – *not* "BDO Seidman, LLP, New York, New York." Plaintiffs therefore cannot (and do not) claim that the opinions *themselves* allowed the market to attribute the statements to Seidman. Instead, plaintiffs seek to prove reliance by cobbling together bits of circumstantial evidence that, in their view, permitted the market to *infer* that *Seidman* issued the allegedly misleading opinions. For example, plaintiffs allege that in 2001 Seidman partner Lee Dewey attended the audited company's shareholders meeting, as well as the "bell-ringing ceremony" on the first day the company's shares traded on the New York Stock Exchange. Sec. Consol. Am. Class Act. Cplt. ("Cplt.") ¶¶ 213-216. Mr. Dewey's presence at these events, plaintiffs say, "makes it appropriate that investors reasonably attributed the false audit opinions to BDO Seidman." *Teachers' Retirement Sys. of Louisiana* v. *ACLN Ltd.*, No. 01-CV-11814 (LP), Decision, at 3 (May 18, 2004) (Appendix "A"-2).

Whether the fraud-on-the-market doctrine can be stretched to accommodate such allegations – and thereby to subject accounting firms to the "hydraulic pressure" of class certification, *Newton* v. *Merrill Lynch*, 259 F.3d 154, 164 (3d Cir. 2001), based on audit reports that do not bear their imprimaturs – is an important question worthy of this Court's immediate attention. Indeed, just weeks ago, the Fourth Circuit – in a strikingly similar context – rejected an inappropriate attempt to use the fraud-on-the-market doctrine to certify a class against an accounting firm precisely because the allegedly misleading statements had not been publicly attributed to the defendant. See *Gariety* v.

*Grant Thornton, LLP*, 2004 WL 1066331, at *12 (4th Cir. May 12, 2004). As the Fourth Circuit recognized, claims of this sort simply do not fit with the framework of *Basic's* presumption of marketwide reliance. For, even if some investors did infer (incorrectly) that Seidman issued the opinions, most investors likely did not, instead concluding (correctly) that the identified author of the opinions was the actual author. There is thus no rational basis on which to presume – and no evidence – that the *market as a whole* attributed the audit reports to Seidman. Reliance on Seidman's alleged misstatements, therefore, must be proven on an investor-by-investor basis, making class treatment of the claims against Seidman impossible. This Court should review and reverse the erroneous class certification against Seidman.

## FACTUAL AND PROCEDURAL BACKGROUND

This is a putative class action brought on behalf of persons who purchased common stock of ACLN Ltd. from June 29, 2000, to March 18, 2002. ACLN is a Cyprus corporation whose primary business was shipping used automobiles from Europe to West Africa. ACLN became a public company and an SEC registrant in 1998. Prompted by a December 21, 2001, news article questioning some of the company's financial disclosures, the SEC began an investigation of ACLN. Ultimately, the SEC suspended trading in the company's stock, and the NYSE delisted ACLN.

In complaints filed on December 21, 2001, plaintiffs sued ACLN, various company insiders, and BDO International – but not Seidman – under Section 10(b) and Rule 10b-5, 17 C.F.R. § 240.10b-5. The complaint alleged that ACLN and its insiders made false public statements about the company and its financial condition and that ACLN's outside auditors issued false and misleading audit reports on two of ACLN's annual financial statements. In September 2002, plaintiffs filed a motion for Rule 23(b)(3) class certification. None of the then-named defendants

opposed the motion, and on November 13, 2002, the district court certified a class. A67-A70. The court found, among other things, that there were questions of fact common to the class, including "whether the market price of ACLN's common stock during the Class Period was artificially inflated because of defendants' conduct complained of." A68-A69.

On December 19, 2002 – more than a month after class certification – plaintiffs filed a Second Consolidated Amended Class Action Complaint, which added Seidman, along with "BDO Cyprus,"[/1] two BDO Cyprus auditors, and BDO International B.V ("BDO BV") as defendants. The claims against these BDO defendants are all based exclusively on the audit reports issued on ACLN's financial statements for the years ended December 31, 1999, and 2000. Plaintiffs contend that these audit reports falsely assert that (1) ACLN's financial statements were fairly presented in conformance with Generally Accepted Accounting Principles ("GAAP") and (2) the audits were performed in accordance with Generally Accepted Auditing Standards ("GAAS"). Cplt. ¶¶ 4, 193. Plaintiffs made no affirmative motion to certify the class as to the new BDO defendants.[/2]

Defendant BDO BV is a Belgian limited liability company that exists *only* to license the brand names "BDO International" and "BDO" to accounting firms across the world. A72. None of its eight employees provides any accounting, auditing, or financial services. A72. Indeed, BDO BV has no clients at all. Moreover, it is an entirely separate legal entity from the member firms that it licenses to use the BDO International name and the BDO acronym. A72-A73.

---

[/1] Although there is no such legal entity as "BDO Cyprus" – the legal name of the BDO International organization's member firm in Cyprus is "BDO International, Accountants and Consultants (Cyprus)" – we will use plaintiffs' nomenclature.

[/2] On May 14, 2004, the district court approved a settlement between plaintiffs and the non-BDO defendants. A22-A35.

One such member firm, BDO Cyprus, has been licensed by BDO BV to use the BDO acronym in Cyprus. BDO Cyprus served as ACLN's "outside auditor" (Cplt. ¶ 30) and "prepared" and issued the 1999 and 2000 audit reports at issue. *Id.* ¶ 34. Those reports were signed with the licensed name "BDO International" and indicated that they were issued from BDO Cyprus's office in Nicosia, Cyprus. Cplt. ¶¶ 197-198; 2000 ACLN 20-F (A83-A84); 1999 ACLN 20-F (A86-A87).

In contrast, Seidman is the BDO member firm licensed to use the BDO acronym *in the United States*. Seidman's role in the ACLN engagement was that of "Filing Reviewer" as described by Appendix K of the AICPA's SEC Practice Section ("SECPS") Reference Manual.[/3] A88-A89. A Filing Reviewer does not perform (and is in no position to perform) any GAAS audit procedures; nor does the Reviewer offer any opinion about whether the financial statements comport with GAAP. *Ibid*. With respect to BDO Cyprus's audits of ACLN's 1999 and 2000 financial statements, Seidman's Filing Reviewer was Lee Dewey. Cplt. ¶¶ 205-207.

In keeping with its limited role as Filing Reviewer, Seidman's name did not appear on ACLN's 1999 or 2000 audit reports. Instead, as noted, the reports were signed "BDO International, Nicosia, Cyprus." When Seidman prepares an audit report, it signs the report "BDO Seidman, LLP." Decl. of Gary A. Orseck in Support of BDO Seidman LLP's Motion to Dismiss, Ex. E. (A66). Nothing in those reports attributes or in any way links them (or the underlying audit) to Seidman.

On March 19, 2003, Seidman filed its first motion to dismiss. Reflecting its understanding

---

[/3] Appendix K requires SECPS members (like Seidman) to serve as Filing Reviewer in order to "enhance the quality of SEC filings by SEC registrants whose financial statements are audited by foreign associated firms." SECPS § 1000.45.01 (A88). The Reviewer must read the documents to be filed and discuss them with the audit partner actually in charge of the engagement. *Ibid*. In so doing, however, the Reviewer "does not assume any of the responsibilities of the audit partner-in-charge of the engagement or of any concurring reviewer." SECPS § 1000.45.01(a) (A89).

that the lawsuit against it would not become a class action unless and until plaintiffs brought, and the district court granted, a class certification motion that analyzed the allegations *against Seidman*, Seidman described plaintiffs as "a purported class." Mem. in Supp. of BDO Seidman's Mot. to Dismiss at 3 (Mar. 19, 2003). Plaintiffs did not indicate then – or for more than a year – that they considered themselves a *certified* class as against Seidman, which had not been a party at the time of the November 13, 2002, class certification order.

Seidman pointed out that none of the allegedly false statements in the audit report was ever issued in Seidman's name. Thus, under *Wright* v. *Ernst & Young*, plaintiffs had not satisfied Section 10(b)'s reliance requirement, which insists that the actionable misstatements must have been publicly attributed to the defendant *before* the plaintiff decided to invest. See 152 F.3d at 175. Moreover, it would not be enough to satisfy *Wright* merely because (as plaintiffs alleged) "the market understood" that the reports were issued by Seidman. *Id*. at 172.

At the May 30, 2003 hearing on Seidman's motion, plaintiffs desperately tried to avoid the clear consequences of *Wright*. Thus, after being pressed by Judge Pollack about the obvious fact that the audit reports themselves attribute nothing to Seidman, plaintiffs' counsel invented an entirely new theory as to why Seidman could be held liable under *Wright*:

> MR. BERGER: Mr. Dewey physically signed the opinion and sent it along to the SEC.
>
> THE COURT: So what you are telling me is that BDO Seidman signed itself under the name BDO International.
>
> MR. BERGER: That is correct. And that's why it is not *Wright*.

5/30/2003 Tr. 41-42 (A63). Recognizing that this theory could not be found in the complaint, the district court gave plaintiffs leave to amend the complaint to add this new allegation. *Ibid.*

Accordingly, on June 13, 2003, plaintiffs amended their complaint, alleging for the first time

that "Seidman partner Lee Dewey physically signed the [1999 and 2000] Audit Reports." Cplt. ¶ 246J. Plaintiffs did *not* allege – because it is so palpably false – that Seidman had ever before issued an audit opinion under the name "BDO International." Nevertheless, the district court concluded that this new signature allegation – *if taken as true* – was sufficient. Indeed, the court relied heavily on that allegation in its decision denying Seidman's motion to dismiss:

> At this stage of the proceedings it is a fair inference from all the facts and circumstances that BDO Seidman, by one of its partners, in fact manually signed the required originals of the audit reports that were filed with the SEC * * * in a way attributable to BDO Seidman, and utilized a name that was deceptively applicable to the moving defendant and its alleged co-engagement partner in Cyprus. These factual predicates and those on the record in this matter satisfy the requirements of *Wright v. Ernst & Young* at this stage of the litigation.

A51. Seidman asked the district court to certify this issue for interlocutory appeal under 28 U.S.C. § 1292(b), but that request was denied. 7/11/2003 Tr. at 22 (A49).

It soon became clear, however, that the signature allegation was completely false, that neither Lee Dewey nor anyone else from Seidman had signed the audit reports. Copies of the manually signed audit reports produced by the plaintiffs showed that they had been signed by one of ACLN's Cyprus auditors, Defendant Minas Ioannou. Yet plaintiffs inexplicably refused to withdraw their allegation, forcing Seidman to move for sanctions under Rule 11. At a hearing on that motion, the district court gave plaintiffs a final chance to salvage the signature allegation: before he "decide[d] to throw plaintiffs out of Court," Judge Pollack demanded to know "everything that Mr. Dewey has to say" (1/20/2004 Tr. at 7 (A41)) about "the critical question" of "did he or didn't he sign the papers" (*id*. at 2(A40)).[/4] After further discovery confirmed that Mr. Dewey had not signed,

---

[/4] Addressing Seidman's counsel, the district court explained the importance of the signature issue: "If [Mr. Dewey] didn't participate and he explains the absence or the presence of a manual signature, I want to know about that. And with none of that, you're home free, your firm will be dealt out under the rule." 1/20/2004 Tr. 6-7 (A41).

plaintiffs finally withdrew the bogus signature allegation. In a February 25, 2004, letter, they advised the court that "Lead Plaintiff does not have sufficient evidence to support the allegation set forth in ¶246J * * * that Lee Dewey physically signed the audit reports * * * for the fiscal years ended December 31, 1999 and December 31, 2000. Accordingly, we are withdrawing that allegation." A37.

In light of those dramatic events, Seidman renewed its motion to dismiss. On March 8, 2004, just days after Seidman filed its motion, Judge Pollack convened an in-chambers conference. At that session, conducted entirely off the record, the court told Seidman that its motion was untimely because it had already answered the complaint.[5] The court inexplicably asserted that plaintiffs' February 25 letter withdrawing a crucial allegation of the answered complaint had not amended the complaint. Decl. of Kathryn S. Zecca ¶ 3 (attached).

The events relating to the motions to dismiss are important to the present application because Judge Pollack seems to believe that they justify not only keeping Seidman in the case, but treating this case as a class action without making the findings required by Rule 23(b)(3). Only after Seidman had begun litigating the issues relating to the signature allegation did it discover that the district court had certified a class based on plaintiffs' first consolidated complaint, which did not name Seidman as a defendant. When Seidman asked plaintiffs when they planned to move for class certification as to Seidman, plaintiffs took the position that the November 13, 2002, certification order already covered Seidman. Letter from R. Hansen (Mar. 12, 2004) (A36). Because that

[5] Even if Seidman's answer did preclude a motion to dismiss under Rule 12(b)(6), the proper course for the district court to follow would have been to convert that motion into one for judgment on the pleadings under Rule 12(c); refusing even to consider Seidman's argument was a clear legal error. See *Patel* v. *Contemporary Classics of Beverly Hills*, 259 F.3d 123, 125-26 (2d Cir. 2001).

position was inconsistent with fundamental principles of due process, see *In re Am. Med. Sys., Inc.*, 75 F.3d 1069, 1086 (6th Cir. 1996), Seidman asked the district court to clarify that the November 13, 2002, order did not apply to Seidman. In the alternative, Seidman argued that, insofar as it *was* covered, the class had to be decertified because attribution of the audit reports to Seidman (and thus plaintiffs' reliance on any false statements allegedly made by Seidman) could be determined only on an investor-by-investor basis, without help from the fraud-on-the-market doctrine.

The district court denied Seidman's motion. Remarkably, the court opened its decision by citing to the discredited signature allegation. Ignoring the fact that plaintiffs had withdrawn that allegation, the court suggested that the "Amended Complaint now states that: Seidman partner Lee Dewey physically signed the Audit Reports." A1. Then, harkening back to its decision based on that allegation, the court pointed out that "Seidman's attribution to those audit reports was raised in the earlier motion by Seidman to dismiss the complaint and failed." A3. Finally, Judge Pollack suggested that attribution has nothing to do with reliance, and therefore is irrelevant to the propriety of class certification based on the fraud-on-the-market doctrine:

> In certifying the Class, the claim was accepted that the market relied on the two audit reports. Whether class members may attribute the improprieties charged to BDO Seidman because of its alleged participation in those reports is a question of damages as to BDO Seidman to be determined on trial of the issues relating to BDO Seidman.

*Ibid*; see also 5/18/2004 Tr. 4 (A15) ("[I]sn't everything that you are doing, your papers now, doesn't everything that you are doing go to the question of a determination of damages in the event that there's a recovery on the part of the plaintiff?"). Because this ruling is so profoundly legally defective – and because it subjects Seidman to the burdens of class certification based on nothing more than untested allegations (some of which the district court knew to be false) – Seidman now

seeks review of that decision under Rule 23(f).[6]

## ARGUMENT

### Seidman's Application Satisfies This Court's Standard for Granting an Application to Appeal a Class Certification Decision Under Rule 23(f)

Rule 23(f) gives "unfettered discretion" to appellate courts to grant litigants permission to appeal from "an order of a district court granting or denying class action certification." FED. R. CIV. P. 23(f), advisory committee's notes. In this Circuit, a petitioner seeking to appeal under Rule 23(f) must demonstrate either "(1) that the certification order will effectively terminate the litigation and there has been a substantial showing that the district court's decision is questionable, or (2) that the certification order implicates a legal question about which there is a compelling need for immediate resolution." *In re Sumitomo Copper Litigation*, 262 F.3d 134, 139 (2d Cir. 2001).[7]

The second showing is made where there is a legal question "of fundamental importance to the development of the law of class actions" that is "likely to escape effective review after entry of judgment." *Sumitomo*, 262 F.3d at 140. This Court's most recent decision applying that standard

---

[6] This Court will no doubt find the May 18 order difficult to comprehend, since it does not on its face even appear to be a class certification order, and plaintiffs never moved for such an order after adding Seidman as a defendant. It is clear, however, that the May 18 order is the first judicial order purporting either to grant certification of a class as against Seidman or to extend to Seidman the order entered when Seidman was not a party to the case. Despite the facial deficiencies of the May 18 order as a Rule 23(b)(3) order, there is no other judicial order from which Seidman could have sought leave to take a Rule 23(f) appeal.

[7] This standard, however, is "a flexible one that should not be reduced to any bright-line rules." *Hevesi*, 366 F.3d at 76 n.4. Accordingly, thus Court has not ruled out granting review simply to overturn an obviously mistaken certification order, a use of Rule 23(f) that has been expressly embraced by several other circuits. See *In re Lorazepam & Clorazepate Antitrust Litig.*, 289 F.3d 98, 105 (D.C. Cir. 2002) ("Where a district court class certification decision is manifestly erroneous, * * * Rule 23(f) review would be warranted even in the absence of a death-knell situation if for no other reason than to avoid a lengthy and costly trial that is for naught once the final judgment is appealed."); *Lienhart* v. *Dryvit Sys., Inc.*, 255 F.3d 138, 145 (4th Cir. 2001).

makes clear that class certification decisions expanding the reach of the *Basic* presumption are particularly appropriate candidates for interlocutory review under Rule 23(f). In *Hevesi*, the Court observed that the "application of the fraud-on-the-market doctrine in a novel context can have a significant effect on the law of class actions because the presumption of reliance created by the doctrine is often essential to class certification in securities suits." 366 F.3d at 77.[8] This formulation perfectly captures the present case, in which only the district court's unprecedented extension of the fraud-on-the-market presumption allowed the class claims against Seidman to proceed. See A68-A69.

*Hevesi* also recognized that when such an extension occurs in the context of a large and high-stakes securities fraud case, where class certification so often has the effect of coercing defendants into settlement regardless of the merits of the parties' respective legal positions, there will likely be no effective appellate review after final judgment. See 366 F.3d at 80-81; see also *West* v. *Prudential Secs. Inc.*, 282 F.3d 935, 937 (7th Cir. 2002) ("[V]ery few securities class actions are litigated to conclusion, so review of this novel and important legal issue may be possible only through the Rule 23(f) device."); *Szabo* v. *Bridgeport Machines, Inc.*, 249 F.3d 672, 675 (7th Cir. 2001); cf. *Tardiff* v. *Knox County*, 365 F.3d 1, 3 (1st Cir. 2004) ("One reason for [23(f)] review is a threat of liability so large as to place on the defendant an irresistible pressure to settle.") (citation

[8] Indeed, it is commonly recognized that in Section 10(b) cases where the *Basic* presumption does not apply, individual issues of reliance will typically "overwhelm[] the common ones," making class certification inappropriate. *Basic*, 485 U.S. at 242; see also *Gariety*, 2004 WL 1066331, at *4, *7 (acknowledging the "barriers" to class certification where fraud-on-the-market presumption does not apply and observing that plaintiffs "almost certainly cannot meet the requirements of 23(b) that common issues predominate"); *West*, 282 F.3d at 940 (reversing certification order where presumption of reliance not available); *In re Livent, Inc. Noteholders Sec. Litig.*, 211 F.R.D. 219, 222 (S.D.N.Y. 2002).

omitted). Again, this is exactly the situation here. The district court's certification decision, involving a novel and improper application of *Basic*, significantly increased the financial stakes of this ligation for Seidman and significantly decreased the likelihood of a future appeal. Like *Hevesi*, then, this case is an ideal candidate for review under Rule 23(f).

## I. The Fraud-on-the-Market Doctrine Cannot Be Used to Presume Reliance on the Statements Allegedly Made by Seidman Because There is No Basis for Concluding that the Market Attributed Those Statements to Seidman

Reliance, which "provides the requisite causal connection between a defendant's misrepresentation and a plaintiff's injury," is an indispensable element of liability on a Section 10(b) claim. *Basic*, 485 U.S. at 243. "Because proof of reliance is generally individualized to each plaintiff allegedly defrauded, fraud and negligent misrepresentation claims are not readily susceptible to class action treatment, precluding certification of such actions as a class action." *Gariety*, 2004 WL 1066331, at *4. In certain circumstances, however, the fraud-on-the-market doctrine allows reliance to be *presumed* on a classwide basis, thus relieving plaintiffs of the burden of showing that each investor directly relied on the defendant's allegedly false statement in deciding to invest. *Id*. at *5; *Hevesi*, 366 F.3d at 77.

The theory behind this presumption is that an efficient securities market will rapidly incorporate material public information about a company into the stock price. When that occurs, the market acts "as the unpaid agent of the investor" by "transmit[ting] information to the investor in the processed form of a market price." *Basic*, 485 U.S. at 244 (citation omitted). In turn, "[a]n investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price. Because most publicly available information is reflected in the market price, an investor's reliance on any public material misrepresentations, therefore, may be presumed for purposes of a

Rule 10b-5 action." *Id*. at 247.

In this case, the claimed misrepresentations are two unqualified audit opinions on ACLN's 1999 and 2000 financial statements. There are two aspects of such opinions that in combination may affect the market for an issuer's stock. The first is the *content* of the opinion, in which the auditor attests to the quality of the financial statements based upon the standards laid down by GAAP and GAAS. Second, but closely related and equally important, is the *imprimatur* of the firm that issues the opinion. "Although investors might not recognize the publicly traded company's name, they will likely recognize such accounting firm names as Arthur Andersen or Deloitte & Touche." *In re Rospatch Sec. Litig*., 760 F. Supp. 1239, 1251 (W.D. Mich. 1991). Thus, a clean audit opinion signed "PriceWaterhouseCoopers" can be expected to carry more weight with the market than would the same opinion signed "Joe's Accounting Firm." That is exactly the reason why audit reports on financial statements filed with the SEC must be signed by the audit firm itself. Cf. *United States* v. *Arthur Young & Co*., 465 U.S. 805, 817 (1984).

Accordingly, for *Basic's* presumption of reliance to apply to audit reports, there must be – at a minimum – reason grounded in "common sense and probability" (485 U.S. at 246) to believe that *both* of these features of the audit report were incorporated by the market into the price of the security.[9] If the report names or is signed by the defendant, such a conclusion is logical. In this

---

[9] *Basic* can also be read more strongly, to require plaintiffs to make an evidentiary showing (unaided by any inferences or presumptions) that a statement that was actually attributed to the defendant caused a change in the market price. See Jeffrey L. Oldham, *Taking "Efficient Markets" Out of the Fraud-on-the-Market Doctrine After the Private Securities Litigation Reform Act*, 97 NW. U. L. REV. 995, 999 (2003). Although the certification decision here is indefensible on any reading of *Basic*, Judge Pollack certified the class against Seidman without asking plaintiffs to adduce *any* evidence that the market actually attributed the audit reports to Seidman and that such attribution affected the price of ACLN stock. And the court certainly made no findings to that effect.

case, however, Seidman's name does *not* appear on the allegedly false 1999 and 2000 audit opinions; nor is there any other public document that purports to attach Seidman's imprimatur to those opinions. To the contrary, the opinions bear the express imprimatur of a *different* audit firm. Plaintiffs have tried to skirt this difficulty by relying on an improbable implied-attribution theory, according to which Seidman's alleged role as ACLN's auditor is supposedly deducible by piecing together disparate bits of highly circumstantial evidence, primarily involving Lee Dewey's whereabouts on particular occasions. See A2.

That approach stretches *Basic* too far. For there is quite simply no reason to think (and no evidence at all) that the market actually connected these scattered dots in the way that plaintiffs theory requires. Plaintiffs' most prominent claim is that Mr. Dewey's presence at ACLN's bell-ringing ceremony somehow may have led the market to conclude that Seidman issued the company's audit reports. Although Mr. Dewey was among the crowd assembled at the exchange that day, there is no allegation (much less evidence) that he was publicly identified or that any market-movers even knew he was there. Moreover, even if plaintiffs could find someone who (1) was at the ceremony; (2) saw Mr. Dewey; (3) knew of his position at Seidman; and (4) inferred (incorrectly) that Seidman therefore must have issued the audit opinions on ACLN's 1999 and 2000 financial statement, what basis is there in common sense and probability to support a conclusion that the *entire market* had similar information or reached a similar conclusion?

Even if the district court was entirely right to deny Seidman's motions to dismiss based on speculation that *someone* could have believed that Mr. Dewey's presence at these events implicated Seidman in the audit reports, plaintiffs have not explained how such hypothetical individual misim-pressions could have been instantly disseminated *throughout the market* so as actually to affect the

price of ACLN's stock – the only scenario that could justify granting class certification against Seidman in addition to denying its motions to dismiss. There is no support in law or logic for applying the *Basic* presumption to such convoluted allegations of reliance.[10] Indeed, no court has *ever* found that the market attributed an audit opinion to a defendant other than the auditor named in that opinion itself. Accordingly, when he held that a class could nevertheless be certified as to Seidman based on the fraud-on-the-market doctrine, Judge Pollack extended *Basic* into a "novel context" (to audit opinions that do not identify the defendant as the auditor) without identifying a "causal link" between Seidman and the price of ACLN's stock. *Hevesi*, 366 F.3d at 78-79.[11] That novel – and manifestly erroneous – decision warrants review under Rule 23(f).

## II. The Reasons Given by the District Court for Certifying a Class against Seidman Do Not Justify Stretching *Basic* To Reach Plaintiffs' Implied-Attribution Theory

As justification for granting class certification against Seidman despite these deficiencies, the district court suggested that attribution is irrelevant to reliance and is instead merely "a question of damages as to BDO Seidman to be determined on trial of the issues relating to BDO Seidman."

---

[10] Given how implausible plaintiffs' attribution argument is, it is not surprising that it is contradicted by the evidence. The available evidence in fact suggests that market analysts correctly identified ACLN's auditor as – and ascribed the audit opinions to – BDO Cyprus. See "TheStreet.com" (Dec. 14, 2001) (A77) ("Oh, one other thing: [ACLN's] auditors are based in Cyprus"); "EyeShade Report" (Oct. 12, 2001) (A81) (noting that "[ACLN's] auditor, BDO International, is based in Nicosia, Cyprus").

[11] The district court also suggested that attribution of the reports to Seidman could be grounded in plaintiffs' supposed claim "that BDO Seidman had used the name BDO International on various occasions and that BDO Seidman was licensed to do so." A1. Not only is that claim entirely false, but, as plaintiffs themselves told the district court, they in fact *never* alleged that Seidman "sometimes" uses (or previously used) the name "BDO International" in its own audit reports; instead, their claim is only that Seidman did so (for the very first time) in *this* case. See Lead Plaintiffs' Mem. of Law in Opp. to BDO Seidman's Mot. to Dismiss Sec. Consol. Am. Class Action Cplt. as Amended on June 13, 2003 at 1 n.1 (July 3, 2003).

A3.[12] But the attribution requirement articulated in *Wright* v. *Ernst & Young* mandates that a secondary actor (such as an accounting firm) "cannot incur primary liability * * * for a statement not attributed to that actor at the time of its dissemination." 152 F.3d at 175. And *Wright* adopted that rule for one reason: because any more relaxed approach to attribution "would *circumvent the reliance requirements* of the Act, as [r]eliance only on representations made by others cannot itself form the basis of liability." *Ibid.* (emphasis added) (citation omitted).[13]

It is hardly surprising that *Wright* made attribution an integral part of reliance in this way. As a matter of common sense, whether a statement is likely to trigger reliance depends not merely on its content, but also on the *identity* of the speaker. Such a link is particularly important in an auditing case like this one. As explained above, the decision to invest based on an audit report turns as much on who prepared the report as on what it says. And just as the identity of the independent auditor is information crucial to an individual investor, it is equally relevant to the market when it acts "as the unpaid agent of the investor" by transmitting material information in the form of a

---

[12] In so holding, the court essentially adopted plaintiffs' argument that the issue of attribution "is wholly irrelevant" to the reliance element of a Section 10(b) claim and therefore is "irrelevant to the applicability of the fraud-on-the-market presumption." Lead Plaintiff's Mem. of Law in Opp. to BDO Seidman, LLP's Mot. for Clarification at 5.

[13] In this respect, *Wright* was merely following the Supreme Court's lead. After all, the requirement that misstatements must have been attributed to the defendant was designed to ensure that aiding-and-abetting liability, ruled out in *Central Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), did not reappear in a different guise. See *Wright*, 152 F.3d at 175; see also *Gariety*, 2004 WL 1066331, at *12. And the Supreme Court held that aiding-and-abetting claims do not exist under Section 10(b) precisely because such claims would impermissibly permit plaintiffs to recover without proving *reliance*. *Central Bank*, 511 U.S. at 180. Accordingly, attribution is not (as the district court suggested) an issue of relative culpability, of how to apportion damages among different defendants. It is instead a crucial aspect of *each defendant's* liability. See *Wright*, 152 F.3d at 175 (emphasizing that in order for an auditor to incur liability for a false statement, "the misrepresentation must be attributed to *that specific actor* at the time of public dissemination") (emphasis added).

market price. *Basic Inc.*, 485 U.S. at 244.[14]

That attribution is integral to class certification via the fraud-on-the-market presumption is confirmed by the Fourth Circuit's recent decision in *Gariety* v. *Grant Thornton LLP*. As in this case, plaintiffs there sought to hold Grant Thornton (an accounting firm) liable for statements made in public documents not authored by or credited to Grant Thornton. Applying *Basic*, the district court certified a class. After accepting an interlocutory appeal under Rule 23(f), the court of appeals reversed, holding that, before the fraud-on-the-market doctrine could be used to satisfy reliance on a classwide basis, "plaintiffs must demonstrate" that "defendant made a public misrepresentation" *and* that such misrepresentation was "directly attributable to Grant Thornton and not to some other person." *Gariety*, 2004 WL 1066331, at *12.

Accordingly, what a plaintiff must prove to satisfy the reliance element – whether directly or via the fraud-on-the-market presumption – is not merely that he invested in reliance on some misleading statement floating freely through the world. Instead, he must show that he invested in reliance both on the statement *and* on the fact that the *particular defendant* in question (and not someone else) made it. See *Anixter* v. *Home-Stake Prod. Co.*, 77 F.3d 1215, 1225 (10th Cir. 1996) ("Reliance only on representations made by others cannot itself form the basis of liability."); *Hevesi*, 366 F.3d at 79 ("[I]n order to recover from the Citigroup Defendants, each class member will have to prove reliance on one or more of *Grubman's* statements of opinion") (emphasis added). This is the reason for *Wright's* temporal requirement that the misrepresentation be attributed to the

[14] Plaintiffs' own expert agrees entirely with this analysis: "If the auditor's quality is perceived by investors as high (when using the size of the auditing firm to measure quality), then investors are statistically shown to respond more strongly to surprises in reported earnings certified by large, brand-name audit firms compared to smaller, unknown audit firms." Expert Report of Jerold L. Zimmerman ¶ 101 (A11).

"specific" defendant "*in advance* of the investment decision." 152 F.3d at 175 (emphasis added).

The district court thus went seriously astray in holding that the defects in plaintiffs' attribution theory have nothing to do with the propriety of class certification. For, to satisfy the reliance element as to Seidman via the fraud-on-the-market presumption, plaintiffs are required to show that *the market's* attribution of the audit reports *to Seidman* (as opposed to BDO Cyprus or BDO International) affected the price of ACLN's stock. Because those reports were not publicly linked to Seidman, however, and because the necessary connection rests solely on innuendo and speculation, plaintiffs cannot make that showing. (Indeed, the district court did not even require them to try.) And, because *Basic* does not apply, plaintiffs can make out their claims against Seidman only by proving – investor by investor – that they attributed the audit opinions to Seidman before investing. Such individualized proof of reliance plainly would overwhelm the issues common to the class, and it was therefore manifest error for the court to have certified a class against Seidman.

Finally, the court only compounded this error by suggesting that the difficulties of attributing the audit reports to Seidman could not defeat certification because "Seidman's attribution to those reports was raised in the earlier motion by Seidman to dismiss the complaint and failed." A3. This observation ignores the vast differences between denying a motion to dismiss and granting class certification. In doing the former, the district court concluded merely that it could not rule out, based on plaintiffs' bare allegations, that a *particular* investor might have believed that opinions were Seidman's work. The certification question is fundamentally different: the issue here is whether the *market as a whole* actually did attribute the reports to Seidman and priced ACLN's stock accordingly. Plaintiffs' untested attribution allegations neither address nor answer that question.

Moreover, in denying Seidman's motion to dismiss, the district court was not required, or indeed allowed, to go beyond the pleadings. But a court *is* required to go beyond the pleadings when deciding class certification. See *Szabo*, 249 F.3d at 675 ("The proposition that a district judge must accept all of the complaint's allegations when deciding whether to certify a class cannot be found in Rule 23 and has nothing to recommend it."); *Gariety*, 2004 WL 1066331, at *6 ("We conclude that, by accepting the plaintiffs' allegations for purposes of certifying a class in this case, the district court failed to comply adequately with the procedural requirements of Rule 23."). Thus, even if it were *theoretically* possible to make a finding of market reliance based on allegations like those here (which it is not), plaintiffs have offered no *evidence* to support such a finding, and district court has quite improperly declined to require them to do so.[15]

## CONCLUSION

For these reasons, Seidman respectfully requests that the Court grant this application for permission to appeal under Rule 23(f). Seidman also requests an immediate stay of proceedings in the district court pending resolution of this appeal.[16]

---

[15] The district court's failure to subject plaintiffs' attribution allegations to the rigorous scrutiny required by Rule 23 merely because those allegations had (improperly, we submit) survived a motion to dismiss was especially troubling in this case, given that two of the main allegations on which the court relied have been specifically repudiated *by plaintiffs themselves*. Central to the court's 12(b)(6) decision were (1) the now-discredited signature allegation and (2) the suggestion that Seidman "had utilized the name BDO International on various occasions." A51. Given that these pillars of plaintiffs' attribution theory have collapsed, it was entirely inappropriate for Judge Pollack to decline to revisit the attribution issue on the ground that he had already ruled on that issue in denying Seidman's motion to dismiss. Even worse, the court inexplicably *repeated* those discarded allegations in its opinion certifying the class against Seidman. A1-A2.

[16] This Court will stay proceedings under Rule 23(f) when "the likelihood of error on the part of the district court tips the balance of hardships in favor of the party seeking review." *Sumitomo*, 262 F.3d at 140. This application demonstrates the serious errors made by the court below in certifying the class as to Seidman. With a pretrial order due on August 20, and a trial likely to follow soon thereafter, the relief we seek is urgent. The balance of hardships thus clearly favors

Respectfully submitted,

BDO SEIDMAN, LLP
Barbara Taylor
330 Madison Avenue
New York, NY 10017

ROBBINS, RUSSELL, ENGLERT,
ORSECK & UNTEREINER LLP
Gary A. Orseck
Lawrence S. Robbins
Roy T. Englert, Jr.
Kathryn S. Zecca
Brian M. Willen
1801 K Street, NW, Suite 411
Washington, D.C. 20006
(202) 775-4500

*Attorneys for BDO Seidman, LLP*

June 1, 2004

Seidman. We therefore ask this Court – as we have asked the district court – for an immediate stay.

## CERTIFICATE OF SERVICE

I hereby certify that on June 1, 2004, I caused true and correct copies of the foregoing to be served on the following:

**By Federal Express:**

Daniel L. Berger
Rochelle Feder Hansen
BERNSTEIN LITOWITZ BERGER & GROSSMAN LLP
1285 Avenue of the Americas
New York, New York 10019
Tel: (212) 554-1400
Fax: (212) 554-1444

*Attorneys for Lead Plaintiff and Lead Counsel for the Class*

**By First Class U.S. Mail:**

Arthur N. Abbey
Joshua N. Rubin
ABBEY GARDY, LLP
212 East 39th Street
New York, New York 10016

*Plaintiffs' Counsel, Executive Committee*

Steven Schulman
Samuel H. Rudman
Pater Safirstein
MILBERG WEISS BERSHAD HYNES & LERACH LLP
One Pennsylvania Plaza, 49th Floor
New York, New York 10119-0165

Thomas A. Holman, Esq.
STARR & HOLMAN LLP
10 East 40th Street, 29th Floor
New York, New York 10016

*Plaintiffs' Counsel, Executive Committee*

Joseph Weiss
Jack Zwick
WEISS & YOURMAN
551 Fifth Avenue, Suite 1600
New York, New York 10176

Wendell Y. Tong
Kevin I. Yourman
WEISS & YOURMAN
10940 Wilshire Boulevard, 24th Floor
Los Angeles, CA 90024

*Plaintiffs' Counsel, Executive Committee*

Kevin W. Goering
Damion K.L. Stodola
COUDERT BROTHERS LLP
1114 Avenue of the Americas
New York, New York 10036

*Attorneys for Defendant BDO International B.V.*

John Cambria
SALANS
Rockefeller Center
620 Fifth Avenue
New York, New York 10020

*Attorneys for Defendant BDO Minas Ioannou, Minas Ioannou, and Christakis Ioannou*

Dated: Washington, DC
June 1, 2004

_____
GARY A. ORSECK

**IN THE UNITED STATES COURT OF APPEALS**
**FOR THE SECOND CIRCUIT**

| | |
|---|---|
| **TEACHERS' RETIREMENT SYSTEM OF LOUISIANA, ET AL.** | ) |
| **Plaintiffs-Respondents,** | ) |
| **v.** | ) |
| **ACLN LTD., ET AL.** | ) |
| **Defendants,** | ) |
| **BDO SEIDMAN LLP** | ) |
| **Defendant -Applicant** | ) |

**DECLARATION OF KATHRYN S. ZECCA IN SUPPORT OF BDO SEIDMAN, LLP'S APPLICATION FOR PERMISSION TO APPEAL PURSUANT TO FEDERAL RULE OF CIVIL PROCEDURE 23(f)**

I, Kathryn S. Zecca, hereby declare:

1. I am a partner in the firm of Robbins, Russell, Englert, Orseck & Untereiner LLP, counsel of record for defendant BDO Seidman, LLP in this action. I am fully familiar with the facts and circumstances set forth herein. I submit this declaration in support of BDO Seidman, LLP's Application for Permission to Appeal Pursuant to Federal Rule of Civil Procedure 23(f).

2. On March 8, 2004, I attended a conference in the Chambers of the Honorable Milton Pollack in the above-titled action. There was no court reporter present and the conference was conducted off the record. I took detailed hand-written notes of the proceedings.

3. Judge Pollack began the conference by announcing that Seidman's Motion to Dismiss was out of time because the complaint had been served and Seidman had already filed an answer. Judge Pollack stated that a motion to dismiss could not be considered after an answer had been filed.

The Court further stated that plaintiffs had not amended their complaint by their February 25, 2004 letter withdrawing their allegation that Seidman partner Lee Dewey had manually signed the audit opinions for ACLN's 1999 and 2000 financial statements.

4. I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Dated: June 1, 2004

_____
Kathryn S. Zecca