UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
Civil Division

TEACHERS' RETIREMENT SYSTEM OF LOUISIANA, ET AL.	)	
Plaintiffs,	)	
v.	)	**Case No.: 01-CV-11814 (MP)**
ACLN LTD., ET AL.	)	
Defendants.	)	

MEMORANDUM IN SUPPORT OF
BDO SEIDMAN, LLP'S MOTION TO DISMISS

ROBBINS, RUSSELL, ENGLERT, ORSECK
& UNTEREINER LLP
Gary A. Orseck
Lawrence S. Robbins (LR-8917)
Kathryn S. Zecca
1801 K Street, NW, Suite 411
Washington, DC 20006
Telephone: (202) 775-4500
Fax: (202) 775-4510

Counsel for BDO Seidman, LLP

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INTRODUCTION[1]

As originally framed, this was a garden-variety securities fraud case brought against a fallen public company and its officers and directors. After an article appeared in the financial press raising questions about ACLN – a Cyprus company traded on the New York Stock Exchange – plaintiffs filed a lawsuit alleging that the company and its management violated various provisions of the Securities Exchange Act.

Now, in the Second Amended Complaint, plaintiffs add as new defendants (i) BDO Minas Ioannou (also known as BDO Cyprus), the Cyprus accounting firm that served as ACLN's outside auditor; (ii) two BDO Cyprus auditors who worked on the ACLN engagement; and (iii) BDO Seidman, LLP ("BDO Seidman"). Plaintiffs also assert claims against BDO International, an organization in which both BDO Cyprus and BDO Seidman are member firms. As the new complaint acknowledges, BDO Seidman was *never* ACLN's auditor, and *never* issued any audit opinion (or any other public statement) on ACLN's financial statements. BDO Seidman did, however, serve as the "Filing Reviewer" of ACLN's financial statements. Under SEC Practice Section rules, a U.S. accounting firm that is a member of an organization like BDO International must serve as a "Filing Reviewer" for its "foreign associated" member firms by "reading" the financial statements and "discussing" with the audit partner any accounting issues that "come to the attention of the filing reviewer."

Plaintiffs now propose to embroil BDO Seidman in this litigation precisely because BDO Seidman conscientiously discharged its duties as a Filing Reviewer. First, alleging that BDO Seidman was "intimately involved" with BDO Cyprus's audit engagement, plaintiffs seek to hold

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[1] Plaintiffs filed the instant complaint under seal, presumably because it quotes from documents that were produced in discovery pursuant to a confidentiality order. Because this memorandum does not refer to or incorporate such confidential documents, it is not filed under seal.

BDO Seidman liable for the supposedly fraudulent audit opinions of *BDO Cyprus*. Second, plaintiffs allege that BDO Cyprus and BDO Seidman were really "one firm working on the same engagement" – and that, even if this is not actually true, BDO Seidman conveyed that impression to the public. Finally, plaintiffs claim that BDO Seidman, by virtue of its close involvement in the ACLN engagement, acted as a "controlling person" of BDO Cyprus, and is therefore secondarily liable for BDO Cyprus's alleged fraud.

Each of these claims should be dismissed. First, under the Second Circuit's decision in *Wright* v. *Ernst & Young LLP*, 152 F.3d 169 (1998), a defendant cannot be liable for an alleged misstatement under Section 10(b) unless he *made* the statement and the statement was *attributed* to him at the time it was made – no matter how "intimate" the defendant's involvement in the underlying transaction. Second, courts have repeatedly rejected efforts (like plaintiffs') to hold an accounting firm jointly and severally liable for statements made by its fellow member firm overseas, or to characterize the alleged misstatement as a "scheme" to defraud. Finally, plaintiffs' "controlling person" claim is squarely foreclosed by the governing case law and by plaintiffs' own allegations.

BACKGROUND

Defendant ACLN is a Cyprus corporation that operated out of Antwerp, Belgium. Second Consolidated Amended Class Action Complaint ("Cplt.") ¶ 18. The company began operations in 1978, shipping used vehicles from Belgium to Tunisia. ACLN later expanded its operations to fifteen ports in North and West Africa and also entered the wholesale automobile business. Ex. A (2000 20-F) at 6-7.[2]

[2] All exhibits referenced in this memorandum are attached to the Declaration of Gary A. Orseck, which is filed concurrently with this memorandum.

In 1998, ACLN became a public company and SEC registrant through an initial public offering of approximately $10 million. Its stock traded on the NASDAQ from June 25, 1998 through July 18, 2001, and thereafter on the New York Stock Exchange. Prompted by a December 21, 2001 news article questioning the company's financial disclosures (Cplt. ¶ 153, 160-161), the SEC began an investigation of ACLN. On March 18, 2002, the SEC suspended trading in the company's shares, and the NYSE subsequently "delisted" the stock. Cplt. ¶ 18; ¶¶ 164-173.

Plaintiffs are a purported class of persons who purchased ACLN common stock from June 29, 2000 through March 18, 2002. They filed their first complaint on December 21, 2001, and a Consolidated Amended Class Action Complaint on May 29, 2002 (D.E. 39). Plaintiffs alleged claims against ACLN, several of its officers and directors, and BDO International, under Section 10(b) of the Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5; and insider trading claims against certain officers and directors of ACLN under Section 20A of the Exchange Act, 15 U.S.C. § 78t-1. This is now the Second Consolidated Amended Class Action Complaint, which plaintiffs filed on December 19, 2002. It adds as new defendants BDO Cyprus, two BDO Cyprus auditors, BDO Seidman, BDO International, and BDO International B.V., a Dutch limited company that is not a member of the BDO International network of firms.

A. The Claims Against The ACLN Defendants

Plaintiffs allege that ACLN and certain of its officers and directors ("the ACLN Defendants") issued numerous public statements during the class period that materially misstated the company's financial condition. Cplt. ¶ 2. In particular, plaintiffs contend that, in various press releases and in financial statements filed with the SEC, the ACLN Defendants (i) falsely represented that ACLN owned and used a ship called the "Sea Atef"; (ii) overstated the number of vehicles that the company

shipped to Africa; (iii) misrepresented the qualifications of the members of the company's audit committee; (iv) failed to disclose that the company's former President and CEO, defendant Aldo Labiad, was the subject of an arrest warrant in Tunisia; (v) misrepresented the ownership interest held by company insiders; (vi) understated operating expenses and overstated revenues; (vii) failed to disclose certain transactions between the company and related parties; and (viii) misrepresented the company's cash holdings. See Cplt. ¶ 4; see also *id*. ¶¶ 58-152; 174-175.[3] Plaintiffs allege that these fraudulent misstatements and omissions by the ACLN Defendants violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. Count I. Plaintiffs also claim that certain of the individual ACLN Defendants engaged in insider trading in violation of Section 20A of the Exchange Act (Count II; Cplt. ¶¶ 162-163), and were "controlling persons" of the company and thus secondarily liable under Section 20(a) of the Exchange Act for ACLN's alleged violations of Section 10(b) (Count III; Cplt. ¶¶ 304-308).

B. The Claim Against BDO Cyprus

Defendant BDO Cyprus is "the Cyprus member firm of the international accounting organization defendant BDO International" (Cplt. ¶ 30), a "worldwide network of professional accountancy and consulting firms." Ex. B (SEC 102(e) Order) § III, ¶ 1. BDO Cyprus served as ACLN's "outside auditor" (Cplt. ¶ 30); in that capacity, it issued "audit reports on ACLN's financial statements for fiscal years 1995 through 2000" (Ex. C (SEC Complaint) ¶ 55), signing the reports with the licensed name "BDO International," and stating that the reports issued from BDO Cyprus's office in Nicosia, Cyprus. See Cplt. ¶ 193; see also Ex. D (1999 ACLN 20-F); Ex. A (2000 ACLN

[3] Foreign companies whose stock is publicly traded in the United States, like ACLN, are required to file annual reports with the SEC on Form 20-F, and must attach audited financial statements. They must also file quarterly reports on Form 6-K.

20-F).[4] Defendants Minas Ioannou and Christakis Ioannou were the BDO Cyprus auditors who worked on the ACLN engagements. Cplt. ¶¶ 31, 32, 196.

Plaintiffs allege that BDO Cyprus knew, or was reckless in not knowing, that the audit reports it issued on ACLN's financial statements for the fiscal years ended December 31, 1999 and 2000 were "materially false and misleading" in that they fraudulently misrepresented that (i) ACLN's financial statements were fairly presented in conformance with Generally Accepted Accounting Principles ("GAAP") (Cplt. ¶ 4), and (ii) the audits "had been performed in accordance with 'generally accepted auditing standards [GAAS]'" (Cplt. ¶ 193). As a result of these putative misstatements, plaintiffs say, the company's stock sold during the class period at inflated prices.[5]

C. The Claims Against BDO Seidman

1. Regulatory Background: BDO Seidman's Role As "Filing Reviewer"

BDO Seidman is the United States member firm of BDO International. Cplt. ¶ 205. Its headquarters are in Chicago, and it has dozens of offices throughout the country. BDO Seidman is

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[4] When BDO Seidman performs an audit and issues an audit opinion, it signs its opinions "BDO Seidman, LLP." See Ex. E.

[5] On October 8, 2002, the SEC filed a civil injunctive action against ACLN and three of its officers, charging them with numerous violations of the federal securities laws. *SEC* v. *ACLN, Ltd., et al.*, C.A. No. 02-7988 (S.D.N.Y. 2002). See Ex. F (Final Judgment of Permanent Injunction); see also Ex. B. The SEC's complaint also named as defendants BDO Cyprus ("a Nicosia, Cyprus accounting firm that has served as ACLN's outside auditor since 1996"), and both Minas and Christakis Ioannou. The BDO Cyprus defendants agreed to settle the matter subject to the terms of an order that enjoined them from future violations of the securities laws. They further consented to an SEC administrative order that suspended them from appearing before the SEC and required BDO Cyprus to disgorge all fees ($62,196) earned under the ACLN audit engagements. See Ex. F. The SEC has brought no action against BDO Seidman.

one of the nation's largest accounting firms, apart from the Big Four.[6]

When a foreign member firm of BDO International – such as BDO Cyprus – audits the financial statements of an SEC registrant company, BDO Seidman is required, as a member of the SEC Practice Section ("SECPS") of the American Institute of Certified Public Accountants ("AICPA"), to appoint one of its partners to serve as the "Filing Reviewer." The responsibilities of the Filing Reviewer are spelled out in Appendix K of the SECPS Reference Manual, entitled "SECPS Member Firms With Foreign Associated Firms That Audit SEC Registrants." SECPS § 1000.45 (attached hereto as Ex. G). Appendix K was adopted in 1999 by the AICPA "to obtain the assistance of SECPS member firms . . . to enhance the quality of SEC filings by SEC registrants whose financial statements are audited by foreign associated firms." § 1000.45.01.[7]

Appendix K (SECPS § 1000.45.01) provides that "[t]he procedures performed by the filing reviewer should generally include the following:

> (1) ***Reading the document to be filed with the SEC*** with particular attention given to compliance as to form of the financial statements (and related schedules) and auditors' report with the applicable accounting and financial reporting requirements for such filings by the SEC registrant.
>
> (2) ***Discussing*** with the audit partner-in-charge of the engagement:
>
> > (i) the engagement team's familiarity with and understanding of the applicable U.S. auditing, accounting, financial reporting, and independence standards, including independence requirements of the SEC and the [Independence Standards Board];

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[6] For no apparent reason, plaintiffs often refer to BDO Seidman in the complaint as "BDO-NY." See, *e.g.*, Cplt. ¶¶ 205-221.

[7] A "foreign associated firm" is defined as "a firm domiciled outside of the United States and its territories that is a member of, correspondent with, or similarly associated with an international firm or international association of firms with which the SECPS member is associated." SECPS § 1000.45.01 n.1.

(ii) the significant differences between: (a) the accounting and financial reporting standards used in the presentation of the financial statements included or incorporated in the document to be filed with the SEC and those applicable in the U.S., and (b) the auditing and independence standards of the foreign associated firm's domicile country and those applicable in the U.S.; and

(iii) any significant auditing, accounting, financial reporting, and independence matters that come to the attention of the filing reviewer when performing the procedures described above, including how any such matters were addressed and resolved by the audit partner-in-charge of the engagement.

(3) ***Documenting*** the results of the procedures performed." (Emphasis added).

In addition to identifying what a Filing Reviewer *should* do, Appendix K also specifies what a Filing Reviewer does *not* do. The Filing Reviewer does not perform (and is not in a position to perform) any GAAS audit procedures; nor can the Filing Reviewer offer any opinion as to whether the company's financial statements comport with GAAP. The Filing Reviewer accordingly "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). Indeed, "[b]ecause of the limited nature of the [filing review] procedures described above, it is recognized that the filing reviewer can not and does not assume any responsibility for detecting a departure from, or noncompliance with, accounting, auditing, and independence standards generally accepted in the U.S., independence requirements of the SEC and ISB, or SEC rules and regulations." *Ibid.* For these reasons, "[t]he procedures performed by the filing reviewer described above do not relieve the audit partner-in-charge of the engagement of any of the responsibilities for the performance of the audit of, and the report rendered by the foreign associated firm on, the financial statements included in the document to be filed with the SEC." *Ibid.* With respect to BDO Cyprus's audits of ACLN's fiscal year 1999 and 2000 financial statements, the BDO Seidman Filing Reviewer was Lee Dewey. Cplt. ¶¶ 205-207.

2. Plaintiffs' Fraud And "Controlling Person" Allegations

In Counts IV and V of the Second Amended Complaint, plaintiffs assert a loose amalgam of claims against BDO Seidman, all arising from its role as "Filing Reviewer" on the ACLN engagement.

In Count IV, plaintiffs contend that BDO Seidman is *directly* liable for the two allegedly false audit opinions. First, they claim that, notwithstanding Lee Dewey's limited role as Filing Reviewer, BDO Seidman became "directly and intimately involved with the ACLN engagement . . . and functioned as part of the ACLN 'audit team.'" Cplt. ¶ 205. See also ¶ 221 (alleging that BDO Seidman "was a direct participant in the preparation of ACLN's filings with the SEC"); ¶ 222 (Lee Dewey was "an integral member of the ACLN audit team"); ¶¶ 223-246 (same). In support of this theory, plaintiffs also allege (Cplt. ¶ 207) that BDO Seidman "was presented to the investment community and potential lenders as part of the ACLN 'audit team,' if not as ALCN's auditors.'" See ¶¶ 208-218 (alleging that BDO Seidman's "participation" led to the "perception" that BDO Seidman was "part of the company's audit team").

Second, and seemingly in the alternative, plaintiffs allege that BDO International was structured in such a way that the various member firms – like BDO Cyprus and BDO Seidman – appeared to be part of "one large global firm." Cplt. ¶ 265. According to the complaint, BDO International is liable for BDO Cyprus's fraud because all member firms of BDO International are merely "regional offices" of a "single global partnership or joint venture" (Cplt. ¶ 194); from that premise, the plaintiffs appear to be saying (Cplt. ¶ 206), *BDO Seidman* must be held liable for *BDO Cyprus's* audit opinions. Conversely, plaintiffs add, if BDO Cyprus and BDO Seidman are *not* part of the same "global" firm, BDO Seidman is *still* directly liable under Section 10(b) because, through

the use of "devices, schemes, or artifices" to defraud, it "creat[ed] the false perception" that BDO International is in fact one international accounting firm. *Id*. ¶ 280.

Finally, in Count V, plaintiffs allege that even if BDO Seidman is not *directly* liable under Section 10(b) for BDO Cyprus's allegedly fraudulent audit opinions, it is *secondarily* liable as a "controlling person" of BDO Cyprus under Section 20(a) of the Exchange Act. According to this theory, BDO Seidman "had the power and influence" to control the actions of BDO Cyprus (Cplt. ¶ 321) and the "ability to control the contents of [BDO Cyprus's audit opinions] and/or prevent the[ir] dissemination" (*id*. ¶ 319). It is therefore liable for BDO Cyprus's alleged violations of Section 10(b). Cplt. ¶ 322.

ARGUMENT

A motion to dismiss may be granted where "it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Nettis* v. *Levitt*, 241 F.3d 186, 191 (2d Cir. 2001) (internal quotation omitted). In assessing the sufficiency of a complaint under Rule 12(b)(6), the court may consider "the face of the complaint" (*Automated Salvage Transp., Inc.* v. *Wheelabrator Environmental Sys., Inc.*, 155 F.3d 59, 67 (2d Cir. 1998)), as well as orders and other matters of public record. *Taylor* v. *Vermont Dep't of Educ.*, 313 F.3d 768, 776 (2d Cir. 2002). In addition, the court may consider documents that plaintiffs either possessed or knew about and upon which they relied in bringing the suit, including those cited in the complaint. *Rothman* v. *Gregor*, 220 F.3d 81, 88 (2d Cir. 2000). The court may also consider documents required to be filed with the SEC. *Rothman*, 220 F.3d at 88.

Although a court generally accepts as true the facts alleged in the complaint, it "need not feel constrained to accept as truth" allegations "that are contradicted . . . by facts of which the court may

take judicial notice." See *In re Livent, Inc. Noteholders Sec. Litig*., 151 F. Supp. 2d 371, 405-06 (S.D.N.Y. 2001) (citing *Hirsch* v. *Arthur Andersen & Co.*, 72 F.3d 1085, 1095 (2d Cir. 1995)). Moreover, "[t]he court need not credit conclusory statements unsupported by assertions of facts or legal conclusions and characterizations presented as factual allegations." *Id*. at 404.

I. PLAINTIFFS' CLAIM AGAINST BDO SEIDMAN UNDER SECTION 10(b) SHOULD BE DISMISSED

To state a claim under Section 10(b) and Rule 10b-5 based on a material misrepresentation or omission, "a plaintiff must plead that the defendant made a false statement or omitted a material fact, with scienter, and that plaintiff's reliance on defendant's action caused plaintiff injury." *San Leandro Emergency Med. Group Profit Sharing Plan* v. *Philip Morris Cos.*, 75 F.3d 801, 808 (2d Cir. 1996). Plaintiffs' Section 10(b) claim against BDO Seidman is based on BDO Cyprus's audit opinions on ACLN's 1999 and 2000 financial statements. See Cplt. ¶¶ 4, 34, 254. Plaintiffs do *not* allege that BDO Seidman issued either of these audit opinions; instead, they assert that BDO Seidman *reviewed* and *edited* drafts of ACLN's financial statements, and *assisted* ACLN's outside auditor, BDO Cyprus. The Second Circuit's decision in *Wright* v. *Ernst & Young LLP*, 152 F.3d 169 (1998), dispositively forecloses that theory, and the claim should therefore be dismissed.

A. Plaintiffs' Section 10(b) Claim Should Be Dismissed Under *Wright* Because Plaintiffs Have Failed To Identify Any Misstatement That Was Made By And Attributed To BDO Seidman

1. In *Central Bank of Denver* v. *First International Bank of Denver*, 511 U.S. 164 (1994), the Supreme Court held that there is no cause of action for aiding and abetting a violation of Section 10(b) and Rule 10b-5, which – by their terms – "prohibit[] only the *making* of a material misstatement (or omission)." 511 U.S. at 177 (emphasis added). Applying *Central Bank*, the

Second Circuit in *Wright* v. *Ernst & Young LLP*, dismissed a Section 10(b) claim against an auditor based on an allegedly false press release that was not made by, or attributed to, the auditor. The Court held that it was not sufficient to allege that Ernst & Young had "provided false and misleading advice" to the issuer, or that it had "'signed-off' or approved the financial information within th[e] press release." 152 F.3d at 172. Nor did it matter that "the market understood the press release as an implied statement by Ernst & Young that the financial information contained therein was accurate." *Ibid*. As the Second Circuit explained, "if *Central Bank* is to have any real meaning, a defendant must actually *make* a false or misleading statement in order to be held liable under Section 10(b). Anything short of such conduct is merely aiding and abetting, and no matter how substantial that aid may be, it is not enough to trigger liability under Section 10(b)." *Id*. at 175 (emphasis added) (quoting *Shapiro* v. *Cantor*, 123 F.3d 717, 720 (1997)). Moreover, because Section 10(b) requires a showing that the plaintiff *relied* on the defendant's misstatement, "the misrepresentation must be attributed to *that specific actor* at the time of public dissemination." *Id*. at 175 (emphasis added).

In light of *Central Bank*, the Court held, "accountants . . . may no longer be held primarily liable under § 10(b) for mere knowledge and assistance in the [alleged] fraud." *Id*. at 176. See also *Shapiro*, 123 F.3d at 720 ("Allegations of 'assisting,' 'participating in,' 'complicity in' and similar synonyms . . . all fall within the prohibitive bar of *Central Bank*."); *Mishkin* v. *Ageloff*, C.A. No. 97-2690, 1998 WL 651065, at *16 (S.D.N.Y. Sept. 23, 1998) ("*Shapiro* strongly suggests that 'orchestration' of misstatements or omissions is not enough to sustain primary liability."). Accord *Ziemba* v. *Cascade Int'l, Inc.* 256 F.3d 1194, 1205 (11th Cir. 2001) ("the alleged misstatement or

omission upon which a plaintiff relied must have been publicly attributable to the defendant at the time that the plaintiff's investment decision was made").[8]

2. Plaintiffs' fraud claim against BDO Seidman is, in every relevant respect, indistinguishable from the claim that the Second Circuit rejected in *Wright*. Just as in that case, plaintiffs fail to identify any alleged misstatement that was made by – and attributed to – BDO Seidman. To the contrary, the complaint freely concedes that it was *BDO Cyprus* that "audited ACLN's financial statements for fiscal years 1995 through 2000" (Cplt. ¶ 196), and that it was *BDO Cyprus* that issued the two audit opinions on which plaintiffs base their fraud claim against BDO Seidman. Under *Wright*, BDO Seidman cannot be held liable for the alleged misstatements contained in the audit opinions of BDO Cyprus. See, *e.g.*, *In re Sotheby's Holdings, Inc.*, No. 00 Civ. 1041, 2000 WL 1234601, at *5-*6 (S.D.N.Y. Aug. 31, 2000) (dismissing Section 10(b) claim against subsidiary where alleged misstatements were attributed to parent corporation).

Plaintiffs allege, however, that BDO Seidman partner Lee Dewey "review[ed]" and "edited drafts of [ACLN's] filings with the SEC" (Cplt. ¶ 223), that he "consulted" and "questioned" BDO Cyprus on various accounting issues, and that he drafted footnotes and prepared numbers for ACLN's financial statements. *Ibid.* See also ¶¶ 224-233 (cataloguing Dewey's many "comments" and "suggestions" and "concerns" on accounting issues that were brought to his attention); see also ¶ 206 (alleging that BDO Cyprus would not "sign off on any ACLN engagement" until Mr. Dewey "reviewed and commented on BDO Cyprus's work"). According to the complaint, because Mr.

[8] In adopting this "bright line" rule (152 F.3d at 175), the Second Circuit rejected the Ninth Circuit's "substantial participation" standard (*id*. at 176). Under the latter test, an auditor may be held liable for statements made by and attributed to someone else, so long as the auditor had a "significant role" in formulating the statement. See *ibid*. (citing *In re Software Toolworks Secs. Litig.*, 50 F.3d 615, 628 n.3 (9th Cir. 1994)).

Dewey "was involved in and had responsibility with respect to the ACLN engagement," his firm, BDO Seidman, is "responsible for the audit reports issued on ACLN's financial statements . . . and is therefore liable because the reports were materially false and misleading."

But that is *exactly* what the plaintiffs in *Wright* said about Ernst & Young. See 152 F.3d at 172 (Ernst & Young gave "advice" to the client and "signed-off" before the press release issued). See also *Ziemba*, 256 F.3d at 1205 (affirming dismissal of Section 10(b) claim based on allegations that the defendant had a "significant role in drafting, creating, reviewing or editing [the] allegedly fraudulent letters or press releases"); *Copland* v. *Grumet*, 88 F. Supp. 2d 326, 332-33 (D.N.J. 1999) (generation of financial data to be included in financial statements does not constitute the "making" of a misstatement); *In re JDN Realty Corp. Secs. Litig.*, 182 F. Supp. 2d. 1230, 1247-48 (N.D. Ga. 2002) (same). Regardless how many documents Mr. Dewey allegedly reviewed, or how many comments Mr. Dewey allegedly provided, his performance as a Filing Reviewer cannot, as a matter of law, constitute the making of an actionable misstatement. "Anything short of [making a misstatement] is merely aiding and abetting, and *no matter how substantial that aid may be*, it is not enough to trigger liability under Section 10(b)." *Wright*, 152 F.3d at 175 (quoting *Shapiro*, 123 F.3d ad 720) (emphasis added). That is enough to dismiss Count IV.

Nor does it matter that ACLN and the investment community supposedly "viewed" BDO Seidman "as part of the Company's audit team." Cplt. ¶ 208; see *id*. ¶ 209-218. Absent an allegation that BDO Seidman actually made a fraudulent misstatement that was *attributed* to it, plaintiffs' speculation about how the public "perceived" BDO Seidman is beside the point. See *Wright*, 152 F.3d at 172 (rejecting Section 10(b) claim based on the theory that "the market understood" the allegedly fraudulent press release to be "an implied statement" by Ernst & Young).

3. If the law were otherwise, then the salutary purposes of Appendix K of the SECPS Manual would be completely undermined. Appendix K provides that a Filing Reviewer should generally "read" the document to be filed with the SEC (SECPS § 1000.45.01(a)(1)), "discuss" various issues with the audit partner (*id*. §§ 1000.45.01(a)(2)(i) and (ii)), and raise "any significant accounting or auditing issues that come to [his] attention" (*id*. § 1000.45.01(a)(2)(iii)). According to the plaintiffs, that is precisely what Mr. Dewey did here. See, *e.g.*, Cplt. ¶¶ 205, 219 (alleging that Lee Dewey "participated in the preparation, drafting, editing and review" of ACLN's financial statements); Cplt. ¶¶ 208, 210 (detailing extensive communications between Lee Dewey and BDO Cyprus regarding various accounting issues that allegedly arose under GAAP and GAAS). Appendix K makes clear that these functions are designed merely to "provide assistance" to the foreign firm performing the audit. SECPS § 1000.45.01. And "assistance" – whether in the form of reviewing, advising, discussing or general kibbitzing – simply cannot give rise to liability in the wake of *Central Bank* and *Wright*.

Plaintiffs' contrary view would also mean – perversely enough – that the *more thoroughly and conscientiously* a Filing Reviewer does his job, the more likely he would be to subject his firm to liability. That would be harsh medicine indeed for purposes of Appendix K. Those rules were designed to "enhance the quality of SEC filings by SEC registrants audited by foreign associated firms" – and that sensible purpose would be materially impaired if the Filing Reviewer could be held liable precisely because he did his job well.

In short, the audit opinions challenged by plaintiffs were issued by and attributed to BDO Cyprus (using the licensed name, BDO International). They were not the opinions of, and were not attributed to, BDO Seidman. Under *Central Bank* and *Wright*, plaintiffs have failed to allege that

BDO Seidman has made an actionable misstatement, and they have therefore failed to state a claim under Section 10(b).

B. Plaintiffs Cannot Salvage The Case By Alleging That BDO Seidman And BDO Cyprus Are Merely Two Offices Of A Single Global Firm

Although the complaint is a bit fuzzy on the point, plaintiffs' "global firm" theory seems to have four steps: first, that BDO International is "one large global firm" and "operates as a single entity" (Cplt. ¶ 265); second, that BDO Seidman and BDO Cyprus are member firms of BDO International (Cplt. ¶¶ 30, 205); third, that *BDO International* is therefore liable for *BDO Cyprus's* derelictions; and finally, that the derivative liability of BDO International extends to *all* of its member firms, including BDO Seidman (Cplt. ¶ 206). In essence, this theory (assuming we have correctly divined the meaning of the complaint) asserts that BDO Seidman – along with the rest of the 99 member firms of BDO International – are partners in a single partnership and are jointly and severally liable for each member's debts. That theory is frivolous.

BDO International is a "worldwide network of professional accountancy and consulting firms." See Ex. B (SEC 102(e) Order § III, ¶ 1). Numerous courts – both in this district and elsewhere – have rejected claims that international accounting organizations like BDO International should be treated as "one global firm." Thus, in *Reingold* v. *Deloitte Haskins & Sells*, 599 F. Supp. 1241 (S.D.N.Y. 1984), plaintiffs attempted to assert personal jurisdiction over the Australian affiliate of the international organization Deloitte, Haskins & Sells by attributing the actions of the United States affiliate to the Australian firm. The plaintiffs relied on the same types of materials mentioned in the Second Amended Complaint here – snippets from marketing materials and references to the international organization as "the firm." Compare 599 F. Supp. at 1254 n.10 to Cplt. ¶¶ 206, 216

(quoting Mr. Dewey as referring to "our firm" when describing BDO); 265-72 (describing marketing materials). Notwithstanding those allegations, the court held that plaintiffs had failed to allege that the Australian firm was a "department or agency" of the U.S. firm: "The parent's boastful advertising does not show in any way that corporate identities were otherwise ignored by the participants in the conduct of the enterprises." *Id*. at 1254 n.10.

Similarly, in *In re Lernout & Hauspie Secs. Litig.*, 230 F. Supp. 2d 152 (D. Mass. 2002), the court refused to hold member firms of KPMG International jointly and severally liable for the alleged misstatements of other member firms: "Several courts have declined to treat different firms as a single entity, holding them jointly and severally liable for one another's acts, simply because they shared an associational name and/or collaborated on certain aspects of a relevant transaction." *Id*. at 170. These cases are dispositive. Were the law otherwise (as plaintiffs appear to suggest), far-flung BDO International member firms such as BDO Zambia (discussed at paragraph 266 of the complaint) would be equally liable for the allegedly fraudulent audit opinions of BDO Cyprus. Plaintiffs' "global firm" theory is unsustainable.[9]

C. Plaintiffs Do Not State A Claim Against BDO Seidman By Alleging That BDO Seidman Participated In A "Scheme to Defraud"

Plaintiffs next try to fashion a theory of Section 10(b) liability that does not require proof that BDO Seidman made a misstatement at all. In a single paragraph on page 99 of the complaint, plaintiffs allege that BDO Seidman (as well as BDO International and BDO Cyprus) are liable under

[9] It also bears mention that plaintiffs' allegations directly contradict their theory that BDO Cyprus and BDO Seidman are merely two regional offices of a single partnership. Plaintiffs make a special point (Cplt. ¶ 219(a)-(m)) of citing invoices that were sent directly from BDO Seidman to ACLN, presumably to demonstrate that BDO Seidman "participated" in the ACLN audit engagement. If BDO Seidman and BDO Cyprus were partners in a single firm (as plaintiffs allege), BDO Seidman would not have sent separate bills to ACLN for its services.

Section 10(b) because they "employed devices, schemes, or artifices to defraud . . . investors in connection with their purchases of ACLN stock." Cplt. ¶ 280. In particular, they claim that, if BDO International is not one "large global firm" after all, then BDO Seidman should be held liable for *falsely creating the impression that it is*. By "creating the false perception" that all BDO entities constitute a single global firm (*ibid.*), BDO Seidman (and the other BDO defendants) ostensibly violated the portion of Rule 10b-5 that proscribes the unlawful use of "devices, schemes or artifices to defraud."

That theory cannot save the day for plaintiffs. To begin with, the "devices, schemes, or artifices to defraud" language of Rule 10b-5 does not expand the range of conduct proscribed by Section 10(b), which "prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act." *Central Bank*, 511 U.S. at 177. See *SEC* v. *Zandford*, 122 S. Ct. 1899, 1901 n.1 (2002) ("The scope of Rule 10b-5 is coextensive with the coverage of § 10(b).). Accordingly, absent an allegation that BDO Seidman made an actionable misstatement, plaintiffs' Section 10(b) claim can survive dismissal only if the alleged "one large global firm" representation constitutes a "manipulative act." It plainly does not.

"Manipulation" under Section 10(b) is a term of art that refers only to a narrow category of "practices, such as wash sales, matched orders, or rigged prices that are intended to mislead investors by artificially affecting the market activity." *Santa Fe Indus., Inc.* v. *Green*, 430 U.S. 462, 476 (1977). See also *In re Blech Secs. Litig.*, No. 94 Civ. 7696 RWS, 2002 WL 31356498, at *3 (S.D.N.Y. Oct. 17, 2002) (quoting *Santa Fe*). "The unifying element in [] manipulative devices . . . is that they are 'used to persuade the public that activity in a security is the reflection of genuine demand instead of a mirage." *Billard* v. *Rockwell Int'l Corp.*, 526 F. Supp. 218, 222 (S.D.N.Y.

1981). Thus, for example, a company officer and an investment banker engage in market "manipulation" when they conspire to withhold shares from the market to drive up the price of a stock, and then flood the market with the officer's holdings at the inflated price. To allege a manipulative practice under Section 10(b) (as opposed to a misstatement), a plaintiff must claim that he was injured "by relying on a market for securities [that was] controlled or artificially affected by defendants' deceptive and manipulative conduct." *Vandenberg* v. *Adler*, C.A. No. 98-3544, 2000 WL 342718, at *7 (S.D.N.Y. Mar. 31, 2000).

That is not what plaintiffs allege here. The "fraudulent scheme" alleged by plaintiffs involves nothing more than the assertion that BDO Seidman and the other BDO entities falsely "represented" that BDO Cyprus's work is subject to the same "stringent conditions" and conforms to the same "standards of quality" that apply to other "offices" of the "global" firm. See Cplt. ¶ 280. That is a run-of-the-mill misstatement claim, not an allegation of "manipulation."

Plaintiffs' "manipulation" theory also fails because the alleged fraud was not committed "in connection with the purchase or sale" of ACLN securities. Section 10(b); see *Chemical Bank* v. *Arthur Andersen & Co.*, 726 F.2d 930, 943 (2d Cir. 1984). As the Supreme Court recently held, to satisfy the statute's "in connection with" requirement, the plaintiff must allege that the "fraud coincided with the sales themselves." *Zandford*, 122 S. Ct. at 1904. Thus, for example, a defendant commits fraud "in connection with" a securities transaction when, without disclosing material inside information, he uses that information to buy or sell a stock (*United States* v. *O'Hagan*, 521 U.S. 642 (1997)), or when the defendant sells the plaintiff a security while intending not to honor the obligation (*Wharf (Holdings) Ltd.* v. *United Int'l Holdings, Inc.*, 532 U.S. 588 (2001)). Here, plaintiffs do not allege that BDO Seidman's supposed "manipulation" – that it purportedly is part

of a "global multinational" partnership – "coincided" with plaintiffs' purchases of ACLN stock; indeed, they do not even allege *when* these unspecified representations were made. Plaintiffs' "device, scheme, or artifice" claim should be dismissed.

II. PLAINTIFFS' CLAIM THAT BDO SEIDMAN IS SECONDARILY LIABLE AS A "CONTROLLING PERSON" SHOULD BE DISMISSED

In Count V, plaintiffs claim that, if BDO Seidman is not *directly* liable under Section 10(b), it is at least *secondarily* liable, under Section 20(a) of the Exchange Act, for the alleged securities violations of BDO Cyprus – its fellow member firm of BDO International. Plaintiffs assert that BDO Seidman "had supervisory involvement" with BDO Cyprus and "had the ability to control the contents" of the audit opinions and to "prevent the[ir] dissemination." *Id.* ¶ 319. "By reason of these relationships," plaintiffs say, BDO Seidman was a "'controlling person' of BDO-Cyprus within the meaning of Section 20(a) of the Exchange Act and had the power and influence to cause BDO-Cyprus to engage in the unlawful conduct complained of." *Id.* ¶ 321. Under the governing case law, however, the complaint does not meet the Section 20(a) standard, and that claim should therefore be dismissed.

1. Under Section 20(a), any person "who, directly or indirectly, controls any person" liable for a violation of the securities laws "shall also be liable" for that violation. 15 U.S.C. § 78t. "In order to establish a prima facie case of controlling-person liability, a plaintiff must show a primary violation by the controlled person and control of the primary violator by the targeted defendant." *SEC* v. *First Jersey Securities, Inc.*, 101 F.3d 1450, 1472 (2d Cir. 1996). Even assuming that plaintiffs have adequately alleged a "primary violation" of Section 10(b) by BDO Cyprus, they fail

by a longshot to allege facts sufficient to state a claim that BDO Seidman exercised the requisite "control" of BDO Cyprus.

"Actual control means the 'practical ability to direct the actions of the controlled person.'" *In re JWP Inc. Secs. Litig.*, 928 F. Supp. 1239, 1259 (S.D.N.Y. 1996) (quoting *Epstein* v. *Haas Secs. Corp.*, 731 F. Supp. 1166, 1175 n.5 (S.D.N.Y. 1990)) (brackets omitted). See also *Lanza* v. *Drexel & Co.*, 479 F.2d 1277, 1299 (2d Cir. 1973); 17 C.F.R. § 230.405 (defining "control" as the "possession . . . of the power to direct or cause the direction of the management and policies of a person"). Merely having the "ability to persuade and give counsel," courts emphasize, "is not the same thing as 'control.'" *Dietrich* v. *Bauer*, 76 F. Supp. 2d 312, 333-34 (S.D.N.Y. 1997) (quoting *Barker* v. *Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 494 (7th Cir. 1986)).

"Actual control" is an exacting standard, and courts do not hesitate to reject "controlling person" claims that fail to allege that the putative "controller" really did have the ability to *direct* (as opposed to merely influence) the controllee's actions. Thus, in *In re Deutsche Telekom AG Sec. Litig.*, C.A. No. 00-9475; 2002 WL 244597 (S.D.N.Y. Feb. 20, 2002), the court dismissed a claim that the German entity KfW was a "controlling person" of Deutsche Telekom, which had allegedly issued false statements in a prospectus. Plaintiffs alleged that KfW "had the power to influence and control . . . the decision-making of Deutsche Telekom, including the content and dissemination" of the prospectus; that KfW had "unlimited access" to the prospectus "prior to and/or shortly after these statements were issued"; and that KfW "had the ability to prevent the issuance of the statements or cause the statements to be corrected." *Id*. at *6. Such allegations, the court held, "simply restate the legal standard for control person liability," and "[c]onclusory allegations that KfW 'controlled' Deutsche Telekom are insufficient for the assertion of liability" under Section 20(a). *Id*. at *7. See

also *In re Blech Secs. Litig.*, 961 F. Supp. 569, 587 (S.D.N.Y. 1997) (dismissing claim that Bear Stearns, the broker for another defendant accused of fraud, was a controlling person, because "an exercise of influence is not 'actual control'"); *Ross* v. *Bolton*, No. 83 CIV. 8244 (WK), 1989 WL 80428, at *4 (S.D.N.Y. Apr. 4, 1998) ("That Bear Stearns *affected* Bolton & Co.'s actions . . . does not mean [] that it *directed* those actions.") (emphasis in original).[10]

2. Mr. Dewey's performance as a Filing Reviewer function fell decisively short of "directing" the assertedly fraudulent actions of BDO Cyprus. Indeed, the very first sentence of Appendix K emphasizes that "SECPS member firms that are members of, correspondents with, or similarly associated with international firms or international associates usually do not control their international organization or individual foreign associated firms." SECPS § 1000.45.01. And nothing in the complaint suggests that Mr. Dewey, by fulfilling his responsibilities as Filing Reviewer, assumed "control" over the "foreign associated firm," BDO Cyprus.

In this regard, *In re Lernout & Hauspie Secs. Litig.*, 230 F. Supp. 2d 152 (D. Mass. 2002), is directly on point. Plaintiffs in that case alleged that KPMG Bedrijsrevisoven – the Belgian member firm of KPMG International – violated Section 10(b) by issuing unqualified audit opinions on the allegedly false and misleading financial statements of a Belgian software corporation. *Id*. at 156. Plaintiffs sought to tag KPMG U.S. and KPMG UK – two other member firms of KPMG International – as controlling persons because they "substantially participated in conducting audits published under KPMG Belgium's name." *Id*. at 175. While allowing the underlying claim against

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[10] Cf. *SEC* v. *First Jersey*, 101 F.3d at 1472-73 (defendant who, during relevant time period, was owner, director, and president could be held liable as controlling person); *Steed Finance LDC* v. *Nomura Sec. Int'l*, C.A. No. 00-8058, 2001 WL 1111508 at *10 (S.D.N.Y. Sept. 20, 2001).

KPMG Belgium to proceed, the court dismissed the "controlling person" claims as to the other two defendants.

"To meet the control element," the court noted, the alleged controlling person "must not only have the *general power* to control the [primary violator], but must also *actually exercise control*" over the primary violator. *Ibid*. (emphasis added) (quoting *Aldridge* v. *A.T. Cross Corp.*, 284 F.3d 72, 85 (1st Cir. 2002)). See *ibid*. ("For the [defendant] to be liable . . . there must be 'significantly probative' evidence that the [defendant] exercised, directly or indirectly, meaningful hegemony over the . . . venture.") (quoting *Sheinkopf* v. *Stone*, 927 F.2d 1259, 1270 (1st Cir. 1991)) (brackets in original). Thus, to state a claim under Section 20(a), the plaintiff must "make two distinct factual allegations: that the 'status' of the controlling entity gave it 'general' power over the controlled entity; and that the controlling entity did, in fact, exercise such power." 230 F. Supp. 2d at 175 (quoting *Aldridge*, 284 F.3d at 85).

The court held that the plaintiffs did not meet that test. First, the allegation that KPMG U.S. and KPMG UK "substantially participated" in KPMG Belgium's audits "does not come close to [the] requirement that 'the alleged control person actually exercise[] control over the general operations of the primary violator." 230 F. Supp. 2d at 175. Second, regardless of the level of the defendants' participation in the audit, the plaintiffs failed to allege that "KPMG U.S. or KPMG UK ever 'actually exercise[d] control' over KPMG Belgium in the issuance of audit reports." *Id*. at 176. To the contrary, the court observed, the "Plaintiffs themselves point to at least one instance in which KPMG Belgium failed to take a series of steps to verify questionable sources of revenue even when 'instructed' to do so by [KPMG U.S.]. Rather than follow [KPMG U.S.'s] instructions, KPMG

Belgium signed off on the 1999 financial statements 'notwithstanding the uncertainty around the validity of the transactions." *Ibid*. (quoting the complaint).

3. Plaintiffs' "controlling person" claim fails the same test. As in *Lernout & Hauspie*, plaintiffs claim, in essence, that BDO Seidman became "intimately involved" with BDO Cyprus's audits of ACLN's financial statements. Cplt. ¶ 205. But merely asserting (as plaintiffs do) that BDO Seidman participated in the audits "does not come close" to the requirement that BDO Seidman "actually exercise[d] control over the *general* operations" of BDO Cyprus. *Lernout & Hauspie*, 230 F. Supp. 2d at 175 (emphasis added). While plaintiffs allege that *BDO International* generally "exercises control over its member firms" (¶ 270), including BDO Cyprus (¶ 320), they do *not* allege that *BDO Seidman* exercises control over the general operations of BDO Cyprus.

Nor do plaintiffs' allegations satisfy the requirement that BDO Seidman "*actually* exercise[d] control" over BDO Cyprus in connection with the ACLN audits. 230 F. Supp. 2d at 175 (emphasis added). Aside from repeating conclusory assertions of "control" (Cplt. ¶ 220) – the very kind of allegation that was held insufficient in *Deutsche Telekom* – the complaint alleges only that BDO Seidman "review[ed]," "edited," "consulted" and "questioned." But the ability to "give counsel is not the same thing as 'control'" *Dietrich*, 76 F. Supp. 2d at 333-34. And while such efforts may arguably constitute "substantial[] participat[ion]" (*Lernout & Hauspie*, 230 F. Supp. 2d at 175), they plainly do not amount to "direction" or "control."

Indeed, just as in *Lernout & Hauspie*, plaintiffs' allegations support the conclusion that BDO Seidman could *not* control BDO Cyprus – even if it had wanted to. Plaintiffs go to elaborate lengths to catalogue the numerous instances in which Mr. Dewey "repeatedly reminded" BDO Cyprus (Cplt. ¶ 238) of its obligations under U.S. accounting rules – as was his responsibility under Appendix K.

See Cplt. ¶¶ 239-246 (alleging that Mr. Dewey repeatedly sent faxes and emails to BDO Cyprus with comments and suggestions regarding the audits of ACLN's financial statements). Notwithstanding Mr. Dewey's prodigious efforts, plaintiffs allege, BDO Cyprus proceeded to *ignore his advice*. See, *e.g.*, Cplt. ¶ 238 (alleging that BDO Cyprus continued to violate the requirements of GAAP and GAAS "notwithstanding Dewey's comments and corrections to their work"); Cplt. ¶¶ 247-264 (alleging that BDO Cyprus violated many of the principal requirements of GAAS and GAAP).

As described in the complaint, the relationship between BDO Seidman and BDO Cyprus is hardly one of "meaningful hegemony." To the contrary, plaintiffs' allegations *foreclose* the possibility that BDO Seidman was a "controlling person" with respect to BDO Cyprus.

CONCLUSION

For the foregoing reasons, plaintiffs' claims against BDO Seidman should be dismissed with prejudice.

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Respectfully submitted,

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Gary A. Orseck
Lawrence S. Robbins (LR-8917)
Kathryn S. Zecca
ROBBINS, RUSSELL, ENGLERT,
ORSECK & UNTEREINER LLP
1801 K Street, NW, Suite 411
Washington, DC 20006
Telephone: (202) 775-4500
Fax: (202) 775-4510

Counsel for BDO Seidman, LLP

Of Counsel:

Scott Univer
BDO Seidman, LLP
330 Madison Avenue
New York, NY 10017