

**UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
Civil Division**

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

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

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Defendant BDO Seidman, LLP submits this reply memorandum in further support of its motion to dismiss plaintiffs' Second Consolidated Amended Class Action Complaint.

I. PLAINTIFFS' SECTION 10(b) CLAIM SHOULD BE DISMISSED BECAUSE PLAINTIFFS DO NOT ALLEGE THAT BDO SEIDMAN MADE A MISSTATEMENT THAT WAS ATTRIBUTED TO IT WHEN MADE

The basis for plaintiffs' Section 10(b) claim is that defendant *BDO Cyprus* made false statements "with respect to its performance of its [fiscal year 1999 and 2000] audits of ACLN in conformity with GAAS and the conformity of ACLN's financial statements with GAAP." Cplt. ¶ 319. In Count IV of the complaint, plaintiffs seek to hold *BDO Seidman* liable for these alleged misstatements because, they say, BDO Seidman partner Lee Dewey, in his capacity as Filing Reviewer on the ACLN audits, was "intimately involved with the ACLN engagement." Cplt. ¶ 205.

To face liability under Section 10(b), however, "a defendant must actually *make* a false or misleading statement" which "must be attributed to *that specific actor* at the time of public dissemination." *Wright v. Ernst & Young LLP*, 152 F.3d 169, 175 (2d Cir. 1998) (emphasis added). As explained in our opening brief (at 10-15), plaintiffs' allegations that Mr. Dewey reviewed and commented on the financial statements that were the subject of BDO Cyprus's audit reports fail the "bright line" test for "making" a misstatement under Section 10(b). Count IV should be dismissed.

1. Faced with this dispositive authority, plaintiffs now insist that "the Complaint most certainly does allege that BDO Seidman issued the false Audit Reports," and therefore it *did* make an actionable misstatement. Br. 11; see also *id.* at 4. That is not so. Tellingly, plaintiffs never quote any of the paragraphs they cite for that proposition, and a quick look at the cited paragraphs reveals why: the complaint alleges no such thing.¹ And having failed to allege a misstatement in the

¹ See Br. 11, 18, citing Cplt. ¶ 4 (alleging that the "BDO Defendants . . . violated the securities laws"); ¶ 34 (alleging that "BDO International" prepared the reports on ACLN's financial statements); ¶ 35 (BDO Seidman was "retained by ACLN to perform accounting, auditing and

complaint, plaintiffs “cannot amend [their] pleading by adding new allegations in [their] briefs.” *Kingdom 5-KR-41, Ltd. v. Star Cruises PLC*, No. 01-CIV-2946, 2002 WL 432390, at *8 (S.D.N.Y. March 20, 2002).²

More to the point, even if plaintiffs *had* alleged that BDO Seidman issued the assertedly false audit opinions, and that those opinions were contemporaneously attributed to BDO Seidman, the claim still would be subject to dismissal because it would be demonstrably false. See *In re Livent, Inc. Noteholders Sec. Litig.*, 151 F. Supp. 2d 371, 405-06 (S.D.N.Y. 2001) (the court “need not feel constrained to accept as truth” allegations “that are contradicted . . . by facts of which the court may take judicial notice”). Plaintiffs do not and cannot dispute that (1) the audit opinions at issue were signed by BDO Cyprus, from its Nicosia, Cyprus office, using the licensed name “BDO International” (see Exs. A and D to BDO Seidman Motion to Dismiss), and (2) when BDO Seidman issues an audit opinion, it signs “BDO Seidman LLP” (Ex. E). Certainly the *SEC* recognized who it was that issued the audit opinions: It filed a civil injunctive action against BDO Cyprus, but took no action against BDO Seidman. See BDO Seidman Opening Br. at 5 n.5 and Ex. F. Plaintiffs can *say* that they assert primary liability against BDO Seidman (Br. 16), but because they fail to allege

consulting services”); ¶ 37 (asserting that BDO International, BDO-Cyprus, BDO-NY and BDO B.V. are referred to in the complaint as the “BDO Defendants” or “BDO International”); ¶¶ 93, 257, 260, 261 (allegations about “BDO International”); ¶ 195 (alleging that BDO Seidman was “directly involved with ACLN”); ¶¶ 205-207 (alleging the BDO Seidman was “intimately involved” with the audit); ¶¶ 219-220 (same); ¶¶ 309-317 (all of the “BDO Defendants” violated Section 10(b)).

² Plaintiffs’ argument that they have adequately alleged *scienter* confirms that the asserted misstatements were uttered by BDO Cyprus, not BDO Seidman. According to plaintiffs (Br. 8), BDO Seidman “knew that BDO Cyprus was not competent to render an opinion as to whether [the] financial statements had been prepared in conformity with GAAP or whether an audit had been conducted in accordance with GAAS.” In other words, plaintiffs’ claim is not that *BDO Seidman* knowingly made a misstatement, but rather that it knew that *BDO Cyprus* made a misstatement.

that BDO Seidman ever *made* any misstatement that was *attributed* to it, plaintiffs’ claim is simply one for “aiding and abetting liability under a different name.” *Wright*, 152 F.3d at 175.³

2. Beyond that, plaintiffs spend the bulk of their 30-page brief cataloguing the ways in which Mr. Dewey allegedly functioned as “part of the audit team.” Br. 1; see Br. 4-7; 9-10; 12-13; 18-19; 25-26. Bolstering their point with an array of adverbs selected to stress the extent of his participation – Mr. Dewey is variously described as being “actively,” “closely,” “integrally,” “critical[ly]” and “extensive[ly]” involved in the BDO Cyprus audits (see Br. 5, 12) – plaintiffs say that “the conclusion that BDO Seidman acted as ACLN’s auditor is inescapable” (Br. 13).

That is both wrong and irrelevant. It is *wrong* because BDO Seidman, as Filing Reviewer, “does not assume any of the responsibilities of the audit partner-in-charge of the engagement,” and accordingly “can not and does not assume any responsibility for detecting a departure from, or noncompliance with, accounting, auditing, and independence standards.” SECPS § 1000.45.01(a).⁴ And it is *irrelevant* because, for purposes of Section 10(b), *it makes no difference* whether BDO Seidman in some sense “functioned as an auditor.” Br. 14. As the Second Circuit has held, “[a]nything 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 (emphasis added) (quoting *Shapiro v. Cantor*, 123 F.3d 717, 720 (2d Cir. 1997)). See

³ Plaintiffs’ failure to allege any misstatement made by BDO Seidman is especially notable because (unlike most plaintiffs) they had the benefit of extensive discovery – including an exhaustive document production by BDO Seidman – before filing the Second Amended Complaint. Cplt. at 2. Plaintiffs cannot survive dismissal on the theory that discovery will vindicate their claims.

⁴ SEC guidance explicitly provides that, if a foreign company is “jointly audited by more than one firm,” “both auditors sign the report.” *Division of Corporate Finance, Accounting Disclosure Rules and Practices – An Overview* at 6-21 (Mar. 31, 2000) (Ex. 1 hereto). BDO Seidman signed neither of the opinions at issue because it was the Filing Reviewer, not the auditor.

also *Cromer Finance Ltd. v. Berger*, 137 F. Supp. 2d 452, 496 (S.D.N.Y. 2001) (dismissing Section 10(b) claim against Deloitte & Touche LLP (the U.S. member firm), based on allegedly false audit opinions issued by Deloitte & Touche Bermuda, for failure to allege a misstatement).⁵

3. Plaintiffs further argue that, even though the audit opinions make no mention of BDO Seidman, it is “appropriate to infer that investors reasonably attributed the false audit reports to BDO Seidman.” Br. 21. Plaintiffs note that Mr. Dewey sometimes used the words “we” and “our” when referring to the audit opinions (Br. 4); that ACLN “present[ed]” BDO Seidman to analysts and lenders as “ACLN’s auditors” (Br. 19); and that Mr. Dewey “appeared at ACLN’s annual meeting of shareholders.” (Br. 9). According to plaintiffs, these allegations, “especially when coupled with BDO Seidman’s high profile” in the U.S., make it “quite reasonable for an investor to attribute the statements at issue to BDO Seidman.” Br. 21. That is beside the point. As this Court has observed, “courts will not impose Section 10(b) liability based merely on ‘inferences’ that a plaintiff claims to have drawn from an otherwise unactionable statement.” *Hart v. Internet Wire, Inc.*, 145 F. Supp. 2d 360, 370 (S.D.N.Y. 2001) (Pollack, S.J.). See also *Wright*, 52 F.3d at 177 (when no misstatement is *attributed* to the defendant, it is irrelevant “what the market might have implicitly ‘understood’”); *In re Sotheby’s Holdings, Inc.*, No. 00 CIV 1041 (DLC), 2000 WL 1234601, at *6 (S.D.N.Y. Aug. 31, 2000 (rejecting plaintiffs’ theory that it would be “reasonable to infer that ‘the financial

⁵ Plaintiffs’ assertion (Br. 15) that nothing in the Filing Reviewer rules “relieves the filing reviewer of the obligation to take action with respect to the violations it does detect” misses the point. No one suggests that the Filing Reviewer rules “relieve” BDO Seidman of any otherwise-existing “obligation”; plaintiffs’ problem is that there is no otherwise-existing obligation. See *Shapiro*, 123 F.3d at 721 (“if an accountant does not issue an opinion about a company, although it may have conducted internal audits or reviews . . . the accountant cannot subsequently be held responsible for the company’s public statements issued later merely because the accountant may know those statements are likely untrue”) (quoting *In re Cascade Int’l Sec. Litig.*, 894 F. Supp. 437, 443 (S.D. Fla. 1995)). See also *ibid.* (“*Central Bank* marked ‘the end of any free-standing duty by collateral participants in securities transactions to blow the whistle.’”) (internal citation omitted).

information and statements . . . were endorsed by” a defendant who did not make the alleged misstatement). Plaintiffs cannot sue BDO Seidman for fraud on the theory that Lee Dewey attended ACLN’s “bell ringing ceremony.” Br. 9.

4. Plaintiffs also say (Br. 17 n.7) that BDO Seidman “disengously” (sic) ignores that *Wright*, *Shapiro*, and the “bevy” of other cases it cites, are all distinguishable. As plaintiffs tell it, these cases are all “predicated on express disclaimers which put the public on notice that the alleged misrepresentations were not the auditors’ statements.” Br. 16-17. That too is wrong. Neither *Shapiro*, *Ziembra v. Cascade Int’l, Inc.*, 256 F.3d 1194, 1205 (11th Cir. 2001), *Copland v. Grumet*, 88 F. Supp. 2d 326, 332-33 (D.N.J. 1999), or *In re JDN Realty Corp. Secs. Litig.*, 182 F. Supp. 2d 1230, 1247-48 (N.D. Ga. 2002), includes any such “disclaimer”; in each of those cases, the complaint was dismissed because there was no misstatement or omission that was “publicly attributable to the defendant.” *Ziembra*, 256 F.3d at 1205. True, the press release at issue in *Wright* stated that the financial results were “unaudited” (152 F.3d at 172), but the Court’s holding did not rely on that fact, much less did the Court establish a rule that a plaintiff can bring a securities fraud suit against anyone who is not excluded by a “disclaimer” in the alleged misstatement.

In re Lernout & Hauspie Secs. Litig., 230 F. Supp. 2d 152 (D. Mass. 2002) (Br. 19-20), is not to the contrary. There, the court denied KPMG U.S.’s motion to dismiss because it was specifically “listed as one of L&H’s ‘principal auditors’” in the very annual reports whose accompanying financial statements were allegedly false. *Id.* at 166. Here, of course, there is no mention of BDO Seidman in *any* of ACLN’s publicly filed documents. More importantly, before the district court addressed the question whether KPMG U.S. could be charged with “making a material misstatement” on those facts, it noted that the First Circuit had not yet decided whether to

follow the Ninth Circuit’s “significant role” test (*id.* at 161) (citing *In re Software Toolworks, Inc.*, 50 F.3d 615, 628 (9th Cir. 1994)) or the much stricter “bright-line” rule set forth in *Wright* and *Shapiro*. The claim survived dismissal in that case only because the court was not required to follow the rule that applies in this Circuit. 230 F. Supp. 2d at 163.

5. Next, plaintiffs attempt to avoid the “attribution” requirement altogether by invoking the “group pleading” doctrine. According to plaintiffs (Br. 21-22), because the audit reports were signed “BDO International,” and because BDO Seidman is a *member* of BDO International, the reports “may be attributed to BDO Seidman for Section 10(b) liability under the group pleading doctrine.” That is errant nonsense.

The group pleading doctrine is an exception to the requirement under Rule 9(b) that the fraudulent acts of each defendant must be identified separately in the complaint. The doctrine “is extremely limited in scope” (*Polar Int’l Brokerage Corp. v. Reeve*, 108 F. Supp. 2d 225, 237 (S.D.N.Y. 2000)); its sole application is to raise a “presumption that statements in prospectuses, registration statements, annual reports, press releases, or other group-published information, are the collective work of those individuals with direct involvement in the everyday business of the company.” *Ibid.* (internal quotation omitted). Accordingly, the doctrine applies *only* to “corporate insiders with active daily roles in the relevant companies or transactions” (108 F. Supp. 2d at 237 (citing *Ouaknine v. MacFarlane*, 897 F.2d 75, 80 (2d Cir. 1990)), and even then only to allow “group pleading” of facts that are “peculiarly within the opposing party’s knowledge” (*DiVittorio v. Equidyne Extractive Indus., Inc.*, 822 F.2d 1242, 1247 (2d Cir. 1987)).⁶

⁶ Plaintiffs assert that the court in the *Polar* case “permitt[ed] group pleading with respect to distinct corporate entities.” Br. 22. That is not so. The “Investment Bank Defendants” in that case – whom plaintiffs apparently believe were independent of the corporate entities that issued the allegedly fraudulent documents – were in fact partners in one of those entities. See 108 F. Supp. 2d

That doctrine plainly has no application here. To begin with, BDO Seidman is not alleged to be an “insider” with “direct involvement in the everyday business” of BDO Cyprus. Cf. *Ouaknine*, 897 F.2d at 80; *DiVittorio*, 822 F.2d at 1249 (group pleading doctrine inapplicable to corporate “affiliates”). What is more, the facts surrounding *who made the alleged misstatements* are not “peculiarly within” BDO Seidman’s knowledge; indeed, there is *no dispute* about the relevant facts: all agree that the audit opinions at issue were signed by BDO Cyprus, using the licensed name “BDO International.” The only question is whether plaintiffs can sue BDO Seidman for an alleged misstatement it did not make. The Second Circuit has said no, and plaintiffs cannot escape that result by invoking the group pleading doctrine.⁷

6. Plaintiffs evidently appreciate the risk that this Court will find that they failed to plead that BDO Seidman made a statement that was attributed to it at the time it was made. As a fallback position, therefore, plaintiffs argue (Br. 23-24) that they have adequately alleged a “scheme or course of business that deceived investors.” That claim fails as well.

Plaintiffs do not dispute that Section 10(b) prohibits only conduct that is “manipulative” or “deceptive.” See *Santa Fe Indus. v. Green*, 430 U.S. 462, 474 (1977). And they do not dispute that “[m]anipulation is virtually a term of art when used in connection with securities markets.” *Id.* at 476. Instead, relying on Rule 10b-5’s prohibition of “any device, scheme, or artifice to defraud” (17 C.F.R. § 240.10b-5(a)), they urge a broad reading of the term “deceptive device or contrivance” (as

at 231 (defining Investment Bank Defendants); *id.* at 236-237 (applying group pleading doctrine).

⁷ In their complaint, plaintiffs advanced the theory that BDO International is “one large global firm” (Cplt. ¶ 265), in which both BDO Seidman and BDO Cyprus are component parts (*id.* ¶¶ 30, 205). From there, plaintiffs asserted that BDO International is liable for BDO Cyprus’s alleged misstatements, and that the derivative liability extends to each BDO International member firm. *Id.* ¶ 206. As explained in our opening brief (at 15-16), that is frivolous. Plaintiffs apparently have abandoned the theory, since they do not attempt to support it in their brief.

used in Section 10(b)), asserting that they can base a claim on a “fraudulent scheme” coupled with “deceptive acts.” Br. 24.

Plaintiffs’ position, however, simply cannot be squared with Supreme Court and Second Circuit precedent. The Supreme Court has made clear that the “[t]he scope of the Rule [10b-5] cannot exceed the power granted the [SEC] by Congress.” *Santa Fe Indus.*, 430 U.S. at 472-73. Thus, regardless whether conduct can be described as a device or scheme, “the statute prohibits *only* the making of a material misstatement (or omission) or the commission of a manipulative act.” *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 177 (1994) (emphasis added). The cases plaintiffs cite in support of their broader reading of Section 10(b) – *In re Enron Corp. Sec. Derivative & ERISA Litig.*, 235 F. Supp. 2d 549 (S.D. Tex. 2002), and *In re Lernout & Hauspie Sec. Litig.*, 236 F. Supp. 2d 161 (D. Mass. 2003) – are both district court decisions from circuits that do not follow the bright-line test set out in *Shapiro* and *Wright*. Compare *Enron*, 235 F. Supp. 2d at 577 (Rule 10b-5 imposes liability on persons who “*participated* in a ‘course of business’ or a ‘device, scheme, or artifice’”) (emphasis added) and *Lernout & Hauspie*, 236 F. Supp. 2d at 173 (Rule 10b-5 imposes liability on “any person who *substantially participates* in a manipulative or deceptive scheme.”) (emphasis added) with *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*.”) (emphasis added). These cases therefore do not reflect the law in *this* Circuit regarding what is required to plead and prove liability under Section 10(b).

Thus, both “schemes” that plaintiffs describe in their brief fail to state a claim under Section 10(b). Plaintiffs first allege (Br. 25) that BDO Seidman “participated in a scheme to defraud the ACLN shareholders by drafting and disseminating documents that contained materially false and

misleading statements.” But that is just a repackaging of the material misstatement claim. See, *e.g.*, *Primavera Familienstiftung v. Askin*, No. 95 Civ. 8905 (RWS), 1996 WL 494904, at *7 (S.D.N.Y. Aug. 30, 1996) (rejecting claim based on alleged fraudulent scheme because “the Complaint is, regardless of how it is framed, one of misrepresentation.”). Plaintiffs’ second theory is based on their allegation that BDO International has portrayed itself “as . . . one large global firm.” Br. 27. This, again, is a run-of-the-mill misstatement claim, and one that fails for an additional reason: As explained in our opening brief (at 18-19), plaintiffs have not alleged that these “misstatements” were made “in connection with” the sale of a security. See *SEC v. Zandford*, 122 S. Ct. 1899, 1903 (2002). Plaintiffs do not even address this issue, except to claim – incorrectly and *ex cathedra* – that they have no legal duty to link BDO Seidman’s conduct “to specific fraudulent stock sales.” Br. 24. The “device, scheme, or artifice” claim should be dismissed.

II. PLAINTIFFS’ “CONTROLLING PERSON” CLAIM SHOULD BE DISMISSED

Plaintiffs claim in the alternative that BDO Seidman is liable as a “controlling person[]” for BDO Cyprus’s allegedly fraudulent audit opinions, because BDO Seidman “had the power and influence to cause BDO-Cyprus to engage in the unlawful conduct complained of.” Cplt. ¶ 321. But it is not enough to “simply restate the legal standard for control person liability”; such “[c]onclusory allegations . . . are insufficient” to state a claim under Section 20(a). *In re Deutsche Telekom AG Sec. Litig.*, C.A. No. 00-9475; 2002 WL 244597, at *7 (S.D.N.Y. Feb. 20, 2002). And while plaintiffs also assert that Lee Dewey, as Filing Reviewer, “review[ed],” “edited,” “consulted” and “questioned” BDO Cyprus’s work (Cplt. ¶ 223), the “ability to persuade and give counsel is not the same thing as ‘control.’” *Dietrich v. Bauer*, 76 F. Supp. 2d 312, 333 (S.D.N.Y. 1997). Plaintiffs therefore fail to allege that BDO Seidman “actually exercise[d] control over the *general* operations”

of BDO Cyprus, or that it “actually exercise[d] control over [BDO Cyprus] *in the issuance of the audit reports.*” *In re Lernout & Hauspie Secs. Litig.*, 230 F. Supp. 2d 152, 175-176 (D. Mass. 2002) (emphasis added). See SECPS § 1000.45.01 (“SECPS member firms . . . usually do not control their international organization or individual foreign associated firms.”)

Oddly enough, plaintiffs’ principal response (Br. 28-30) is that they have sufficiently pleaded “culpable participation” by BDO Seidman – which is an entirely separate element under Section 20(a). Beyond that, plaintiffs just repeat their conclusory assertions of control, and cite to portions of the complaint alleging that BDO Seidman “review[ed] and approv[ed]” draft financial statements – as it was required to do in its role as Filing Reviewer. Simply alleging (as plaintiffs do) that BDO Seidman “substantially participated” in the audits “does not come close” to the required showing of control. *Lernout & Hauspie*, 230 F. Supp. 2d at 175.

If that were not enough, plaintiffs readily concede that “the Complaint cites numerous instances in which, notwithstanding Dewey’s repeated corrections and instructions, BDO Cyprus continued to make the same mistakes.” Br. 29 n. 11 (citing Cplt. ¶¶ 238-264). That is the very reason why the court in *Lernout & Hauspie* dismissed the plaintiffs’ controlling person claim against KPMG U.S. See 230 F. Supp. 2d at 176 (noting that KPMG Belgium failed to perform necessary audit steps “even when ‘instructed’ to do so” by KPMG U.S.). Far from “inapposite,” as plaintiffs say (Br. 29 n. 12), *Lernout & Hauspie* is squarely on point. The “controlling person” claim should be dismissed as well.

CONCLUSION

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

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