UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

ANWAR, *et al.*, Plaintiffs, vs. FAIRFIELD GREENWICH LIMITED, *et al.* Defendants.	Master File No. 09-cv-118 (VM) (THK) ECF Case

REPLY MEMORANDUM OF LAW IN SUPPORT OF PRICEWATERHOUSECOOPERS INTERNATIONAL LIMITED'S MOTION TO DISMISS THE SECOND CONSOLIDATED AMENDED COMPLAINT

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Defendant PricewaterhouseCoopers International Limited ("PwCIL") respectfully submits this Reply Memorandum of Law in Support of its Motion to Dismiss the claims against it in the Second Consolidated Amended Complaint ("Amended Complaint").

PRELIMINARY STATEMENT

Plaintiffs' claims against PwCIL fail because the Amended Complaint does not allege that PwCIL had the power to control PwC Canada and PwC Netherlands in their audits of the Fairfield Funds. In their Opposition, Plaintiffs contend that they need allege only that PwCIL controlled the PwC Member Firms[1] in *any* respect, including those completely unrelated to the Fairfield audits. But in order to state a claim against PwCIL under common law or Section 20(a), the case law unambiguously requires Plaintiffs to allege that PwCIL controlled the PwC Member Firms with respect to the audits at issue.

Plaintiffs try to shore up the Amended Complaint by slipping new factual allegations (with accompanying exhibits) into their Opposition. But the new allegations (descriptions of the governance structure of PwCIL and the general relationship between PwCIL and the PwC Member Firms) do no good, as they simply mirror the allegations and conclusory assertions of control already set forth in the Amended Complaint. Multiple decisions of this Court have held that similar allegations do not fulfill the element of control required to hold PwCIL vicariously liable for the acts of PwC Member Firms. Accordingly, Plaintiffs fail to "'state a claim to relief that is plausible on its face,'" *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949 (2009) (quoting *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555 (2007)), and the Amended Complaint should be dismissed.

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[1] PwCIL adopts the meaning of "PwC Member Firms" and similar shorthand references as used in the Memorandum of Law in Support of PricewaterhouseCoopers International Limited's Motion to Dismiss the Second Consolidated Amended Complaint (the "PwCIL Memorandum").

ARGUMENT

I. PLAINTIFFS HAVE FAILED TO STATE A CLAIM OF VICARIOUS LIABILITY

Plaintiffs agree that "control is the essential characteristic of the principal-agent relationship" (Pls. Opp. at 47),[2] but ignore well-established precedent requiring Plaintiffs to plead PwCIL controlled the PwC Member Firms with respect to the challenged audits.[3]

A. To Establish A Principal-Agent Relationship, Plaintiffs Must Demonstrate Control Of The Underlying Conduct At Issue

Allegations of control for purposes of a principal-agent relationship must relate to the particular conduct at issue: A plaintiff must plead an agreement between the principal and agent "that the principal is to be in control *of the undertaking*." *Manley v. AmBase Corp.*, 337 F.3d 237, 246 (2d. Cir. 2003) (emphasis added).[4] In the accounting context, "[c]ontrol over the [particular] audits performed is required." *Star Energy Corp. v. RSM Top-Audit*, No. 08 Civ. 00329, 2008 WL 5110919, at *5 (S.D.N.Y. Nov. 26, 2008). Accordingly, because the Amended Complaint does not show that PwCIL had the ability to control PwC Canada and PwC Netherlands *with respect to the challenged audits of the Fairfield Funds*, Plaintiffs' claims must be dismissed. *See Nuevo Mundo Holdings v. PricewaterhouseCoopers LLP*, No. 03 Civ. 0613,

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[2] Plaintiffs do not contend that PwCIL itself engaged in tortious conduct under common law, confining their claims instead to vicarious liability under an agency theory. Pls. Opp. at 47.

[3] The vicarious liability claims against PwCIL also fail because Plaintiffs have failed to plead adequately the underlying torts of the PwC Member Firms. *See* PwCIL Mem. at 5; Reply Mem. in Supp. of PricewaterhouseCoopers LLP's Mot. to Dismiss at 8-10; Reply Mem. of Law of Def. PricewaterhouseCoopers Accountants N.V. in Further Supp. of Its Mot. to Dismiss at 5-8. These Reply Memoranda are incorporated herein by reference.

[4] *See also In re Shulman Transp. Enters. Inc.*, 744 F.2d 293, 295-96 (2d Cir. 1984) (holding that, for agency to exist, the "critical element of control" must relate specifically to the acts at issue); *Cabrera v. Jakabovitz*, 24 F.3d 372, 386 (2d Cir. 1994).

2004 WL 112948, at *5 (S.D.N.Y. Jan. 22, 2004); *In re Lernout & Hauspie Sec. Litig.*, 230 F. Supp. 2d 152, 172-73 (D. Mass. 2002); *see also* PwCIL Mem. at 6-7.

Ignoring this precedent, Plaintiffs assert that they need plead only that PwCIL had the power to control "any aspect of PwC Canada's or PwC Netherlands' conduct" (emphasis removed). Pls. Opp. at 47-48; *see also id.* at 49 (referring to PwCIL's "general control" over the member firms); *id.* at 50. But Plaintiffs offer no authority for this purported standard. *See* Pls. Opp. at 47-50. In fact, the cases the Opposition relies upon elsewhere demonstrate that control must relate to the particular conduct at issue. *See, e.g., In re Parmalat Sec. Litig.*, 375 F. Supp. 2d 278, 290 (S.D.N.Y. 2005) (an agency relationship exists "'only where the agent may reasonably infer from the words or conduct of the principal that the principal has consented to the agent's performance of a particular act'") (quoting *Dinaco, Inc. v. Time Warner, Inc.*, 346 F.3d 64, 68 (2d Cir. 2003)). Moreover, Plaintiffs' approach would undermine fundamental tenets of agency law by making principals liable for any and all conduct undertaken by an agent, regardless whether the agency relationship extended to the actions at issue. *See, e.g., Green Door Realty Corp. v. TIG Ins. Co.*, 329 F.3d 282, 289 (2d Cir. 2003).

B. Plaintiffs Fail To Plead That PwCIL Had The Power To Control The Audits Of The Fairfield Funds

Plaintiffs are required to "plead[] factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Iqbal*, 129 S. Ct. at 1949. Here, the Amended Complaint merely couples conclusory assertions of "control" with generic allegations about the structure and organization of the PwC Network—*e.g.*, that PwCIL "provides a global governance structure" for the network and that PwC member firms are "bound by [certain] standards and guidelines." Am. Compl. ¶¶ 153, 268-70, 293-96. This is insufficient under both the pleading standard of *Iqbal* and the cases holding that generic descriptions of

accounting network relationships alone are insufficient to allege the requisite control by the accounting network coordinating entity over the underlying audits. *See* PwCIL Mem. at 10-13.

The Opposition's new allegations and exhibits likewise offer no link between PwCIL and the audits at issue, but merely boil down to further allegations regarding PwCIL's role as a coordinating entity in a global accounting network. *See* Pls. Opp. at 47-53; Decl. of Howard L. Vickery in Supp. of Pls. Opp. ("Vickery Decl."), Exhibits 14-17. For example, the Articles of Association ("Articles") and the "PwC Audit" presentation state that PwCIL develops and promotes common standards, policies and practices; the Declaration of Lawrence W. Keeshan and Global Annual Review describe its leadership structures; the Global Annual Review refers to periodic reviews of member firms; and the 2001 Memorandum of Association and the Articles describe generally PwCIL's "objects" of "provid[ing] guidance" and "coordinat[ing]" the member firms to achieve the "vision, value and principles of the member firms."[5]

Such general allegations—which fail to allege any connection to the audits at issue—have consistently been held insufficient to allege the element of control. *See* PwCIL Mem. at 10-13. In *Star Energy*, for example, the plaintiffs alleged that the coordinating entity (i) promulgated an audit manual and audit policies, (ii) employed a "Compliance Committee," (iii) controlled eligibility for membership in the network and use of the brand name, (iv) performed

[5] Plaintiffs assert that "PwCIL cannot hold itself out as having the right to control the audits conducted by PwC member firms so as to entice clients, and then deny that fact so as to avoid liability." Pls. Opp. at 47. But Plaintiffs have failed entirely to identify any ways in which PwCIL "hold[s] itself out" as having such a right. In fact, the documents included as exhibits to Plaintiffs' Opposition make it clear that PwCIL does *not* hold itself out as having the right to control audits, and undermine any argument that PwCIL in fact has such a right. *See* Global Annual Review, Vickery Decl. Ex. 14 at p. 34 ("PwCIL does not provide services to clients. Its primary activities are to identify broad market opportunities and develop associated strategies; strengthen PwC's internal product, skill and knowledge networks; promote the PwC brand; and develop and work for the consistent application of common risk and quality standards by PwC's member firms, including compliance with independence policies."). *See also id.* ("PwC member firms are locally owned and managed, thereby fostering a deep understanding of local markets.").

periodic reviews of its member firms' procedures, and (v) had the power to force a member firm to change its conduct through sanction or remedial conduct. 2008 WL 5110919, at *1, *3, *5. The plaintiffs in *Star Energy* also alleged that the audited company had contacted the coordinating entity—a specific link between the coordinating entity and the audited company that is entirely lacking here. Nonetheless, even with the alleged contact between the audited company and the coordinating entity, the Court found "the essential element of control [was] lacking" because the allegations "failed to sufficiently allege that [the umbrella entity] controlled or was able to control the particular audits" and "fail[ed] to allege that [the umbrella entity] had any control over [the member firm auditor] in its dealings with [the client]." *Id.* at *4. *See also Nuevo Mundo*, 2004 WL 112948, at *2-*5; *In re Lernout*, 230 F. Supp. 2d at 171-73.

Plaintiffs respond to *Star Energy*, *Nuevo Mundo*, and *In re Lernout* in a solitary footnote that attempts to distinguish these cases from their own. Pls. Opp. at 52 n.43. Plaintiffs seek to distinguish *Star Energy* by pointing to their allegation that personnel at one of the PwC Member Firms also had a position with PwCIL. But Plaintiffs offer no authority holding that personnel overlap alone makes any difference absent an allegation of involvement by that individual in the relevant auditing activities, particularly where Plaintiffs have alleged no contact between the audit client and coordinating entity with respect to the audit at issue. *Cf. Star Energy*, 2008 WL 5110919, at *4. *Nuevo Mundo* cannot be distinguished on the ground that the plaintiffs' argument there was "based solely on allegations that [the Peruvian member firm] and the [US firm] share a common name and the same parent company" (Pls. Opp. at 52), because plaintiffs in that case also alleged the coordinating entity undertook "overall training and supervision of all affiliates," "peer review meetings" to assure compliance, and oversight of the activities of member firms—essentially the same types of allegations made here. 2004 WL 112948, at *2-*5.

See also PwCIL Mem. at 12. Finally, Plaintiffs' conclusory effort to distinguish *In re Lernout*—claiming that plaintiffs there "failed to allege [that] the subsidiaries conducted audits subject to KPMG control"—merely begs the question given the similarities in the pleadings. *See In re Lernout*, 230 F. Supp. 2d at 171-73 (dismissing claims against KPMG International despite allegations regarding "global performance management," "global service teams," common audit tools, and the marketing of KPMG as a "unitary global entity").

Unable to reconcile the cases most on point, Plaintiffs focus on two cases in which the allegations of control were deemed sufficient. But these two cases hinged on the very facts Plaintiffs fail to plead here—namely, a link between the coordinating entity and the challenged audits that would support a reasonable inference of the power to control those audits. In *In re Parmalat*, the plaintiffs alleged that the coordinating entity was consulted on and later intervened in the management of the audits at issue. 375 F. Supp. 2d at 293-94, 301. The plaintiffs in *Cromer* alleged that the partner in charge of the audit was acting in his capacity as the "Asset Global Management Contact" of the coordinating entity when he signed the audits. *Cromer Fin. Ltd. v. Berger*, No. 00 Civ. 2284, 2002 WL 826847, at *2 (S.D.N.Y. May 2, 2002). *See generally Star Energy*, 2008 WL 5110919, at *4-*5 (distinguishing *In re Parmalat* and *Cromer* and noting "critical differences between the factual settings of those cases" and the case at hand). *See also* PwCIL Mem. at 14-15.[6] These cases, accordingly, reinforce the conclusion that Plaintiffs have failed to plead the element of control.

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[6] In a brief footnote, Plaintiffs assert that they have established apparent authority. *See* Pls. Opp. at 50 n.41. However, there is no allegation that PwCIL communicated or represented to anyone, including Plaintiffs, that the PwC Member Firms were authorized "to conduct the *transaction[s] in question*" on its behalf. *Spagnola v. Chubb Corp.*, 264 F.R.D. 76, 90 (S.D.N.Y. 2010) (emphasis added); *see S & S Textiles Int'l v. Steve Weave, Inc.*, No. 00 CIV. 8391, 2002 WL 1837999, at *7 (S.D.N.Y. Aug. 12, 2002). Moreover, as noted in the lone case cited in the Opposition (at n.41), Plaintiffs must allege that they "reasonably relied" on those purported

II. PLAINTIFFS HAVE FAILED TO STATE A CLAIM UNDER SECTION 20(a) OF THE EXCHANGE ACT

Plaintiffs' Opposition also does not correct the pleading deficiencies of their Section 20(a) claim with regard to the elements of control and culpable participation.[7] The prevailing legal standard requires a plaintiff bringing a Section 20(a) claim to allege control over the particular audits at issue. Plaintiffs ignore this standard and argue that the mere power to control any aspect of the PwC Member Firms is sufficient. Not only are Plaintiffs' allegations of PwCIL's generic power to control the PwC Member Firms dubious, but they are also insufficient for purposes of Section 20(a) because they provide no basis for a "reasonable inference," *Iqbal*, 129 S. Ct. at 1949, that PwCIL controlled the Fairfield audits. Plaintiffs' Section 20(a) claim also fails because they have not pled culpable participation, which, despite Plaintiffs' protestations to the contrary, is a required element of a claim under Section 20(a).

A. Plaintiffs Have Failed To Plead Control Over The Challenged Audits

Plaintiffs contend that they need plead control only "over the person liable, not the transaction at issue." Pls. Opp. at 54. But the precedent is clear: "The Section 20(a) defendant must not only be alleged to have 'actual control over the primary violator, but have actual control over the *transaction* in question.'" *In re Alstom SA Sec. Litig.*, 406 F. Supp. 2d 433, 487 (S.D.N.Y. 2005) (citing *In re Global Crossing, Ltd. Sec. Litig.*, No. 02 Civ. 910, 2005 WL

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representations; that is, they must show that they "reasonably believed that [member firms] entered into the [audit engagements] on behalf of [the coordinating entity] and not on [their] own behalf." *Spagnola*, 264 F.R.D. at 91 (declining to dismiss action because plaintiffs sufficiently alleged that they "reasonably believed that they had contracted with [the purported principal] and not [the party to the policy at issue]"). No such allegations exist here.

[7] Plaintiffs' Section 20(a) claim against PwCIL must also be dismissed because they have failed adequately to plead a primary violation of the Exchange Act. *See* PwCIL Mem. at 16; Reply Mem. in Supp. of PricewaterhouseCoopers LLP's Mot. to Dismiss at 2-4; Reply Mem. of Law of Def. PricewaterhouseCoopers Accountants N.V. in Further Supp. of Its Mot. to Dismiss at 1-4.

1875445, at *3 (S.D.N.Y. Aug. 5, 2005)) (emphasis in original) (collecting cases) (Marrero, J.).[8] Plaintiffs' attempt to bring a Section 20(a) claim based on conclusory allegations of *some* control over the PwC Member Firms—as opposed to control over the Fairfield audits—must fail.[9]

Plaintiffs' allegations do not support their Section 20(a) claims because none of those allegations shows that PwCIL had control over PwC Netherlands' and PwC Canada's audits of the Fairfield Funds. Multiple courts have dismissed Section 20(a) claims based on generic allegations similar to those in this case for this reason. *See, e.g., In re Asia Pulp & Paper Sec. Litig.*, 293 F. Supp. 2d 391, 393-94, 396 (S.D.N.Y. 2003);[10] *see also* PwCIL Mem. at 17-19.

Plaintiffs' cases in fact undermine their position. In *Teachers Retirement System of Louisiana v. A.C.L.N., Ltd.*, No. 01 Civ. 11814, 2003 WL 21058090 (S.D.N.Y. May 12, 2003), the plaintiffs alleged that the coordinating entity certified the financial statements at issue and put forth evidence that audit reports routinely were signed by that entity. *Id.* at *1-*2, *5. Further,

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[8] *See also In re Alstom SA Sec. Litig.*, 454 F. Supp. 2d 187, 209 (S.D.N.Y. 2006) (Marrero, J.); *H&H Acquisition Corp. v. Financial Intranet Holdings*, No. 98 Civ. 5269, 2009 WL 3496826, at *7 (S.D.N.Y. Oct. 29, 2009) (Jones, J.); *Pension Committee of Univ. of Montreal Pension Plan v. Banc of Am.*, 592 F. Supp. 2d 608, 637 n.234 (S.D.N.Y. 2009) (Scheindlin, J.); *In re Refco, Inc. Sec. Litig.*, 503 F. Supp. 2d 611, 662 (S.D.N.Y. 2007) (Lynch, J.); *Kalin v. Xanboo, Inc.*, 526 F. Supp. 2d 392, 405 (S.D.N.Y. 2007) (Karas, J.); *In re Global Crossing, Ltd. Sec. Litig.*, No. 02 Civ. 910, 2005 WL 1907005, at *12 (S.D.N.Y. Aug. 8, 2005) (Lynch, J.).

[9] Plaintiffs cite (at 54-55) *CompuDyne Corp. v. Shane*, 453 F. Supp. 2d 807, 829 (S.D.N.Y. 2006), and *Dietrich v. Bauer*, 126 F. Supp. 2d 759, 764-65 (S.D.N.Y. 2001), but those cases do not actually address the question whether control must be over the transaction in question. Plaintiffs' view that only control over the primary actor (not the underlying conduct) is needed rests entirely on *In re Parmalat Sec. Litig.*, 594 F. Supp. 2d 444, 456-57 (S.D.N.Y. 2009), which is contradicted by the vast bulk of recent decisions in this District. *See supra* at 7-8 & n.8. Even were the Court to apply the *Parmalat* standard, however, Plaintiffs offer no authority for their conclusion that generic "one-firm" allegations would suffice. *See infra* n.11.

[10] Plaintiffs attempt to distinguish *In re Asia Pulp* because the complaint in that action "was bereft of any allegations that the auditing firm was able in any way to influence the particular audits conducted or opinions offered by the member firms." Pls. Opp. at 56. Of course, the Amended Complaint here fails for precisely the same reason: there is no allegation that PwCIL influenced the audits or the audit reports, or had the right to control the audits.

the audited client had stated publicly and in SEC filings that the international entity was its auditor. *Id.* at *2. Here there is nothing linking PwCIL to the underlying audits in any way—and Plaintiffs' new exhibits reinforce this point. *See, e.g.,* Global Annual Review, Vickery Decl. Ex. 14 at p. 34 ("PwCIL does not provide services to clients").[11] Because the Amended Complaint lacks well-pleaded allegations of control over the challenged audits, which is "essential" to Section 20(a), the claim should be dismissed. *Kalin*, 526 F. Supp. 2d at 405.[12]

B. Plaintiffs Have Failed To Plead Culpable Participation

Plaintiffs first argue that no allegations of culpable participation are required, and then contend that the Amended Complaint sufficiently alleges culpable participation in any event. *See* Pls. Opp. at 57. Both arguments fail. The cases are clear that, in order to establish a *prima facie* case of control person liability, "a plaintiff must show (1) a primary violation by the controlled person, (2) control of the primary violator by the defendant, and *(3) that the defendant was, in some meaningful sense, a culpable participant in the controlled person's fraud*." *ATSI*

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[11] *In re Parmalat* reinforces the deficiencies in Plaintiffs' pleading. Although that case did not require control over the challenged transaction, that holding is directly contrary to the overwhelming majority of recent cases. *See supra* at 7-8 & n.8. Moreover, the *Parmalat* plaintiffs *did* include allegations linking the network coordinating entity to the challenged audits—namely, its involvement in resolving disputes among member firms concerning the audits. 594 F. Supp. 2d at 453. *Varghese v. China Shenghuo Pharmaceutical Holdings, Inc.*, 672 F. Supp. 2d 596, 611 (S.D.N.Y. 2009), also does not support Plaintiffs' view. There, unlike here, the plaintiffs alleged that the putative control persons "participat[ed] in and/or [were] aware[] of the [underlying] Company's operations," had "intimate knowledge of the false financial statements," and had "direct and supervisory involvement in the day-to-day operation of the Company." *Id.* at 612.

[12] Plaintiffs assert (at 54) the control person inquiry is inappropriate for a motion to dismiss. But the Amended Complaint is wholly devoid of well-pleaded allegations to support a plausible inference of control. "Conclusory allegations of control are insufficient as a matter of law." *See In re Global Crossing*, 2005 WL 1907005, at *12 (collecting sources). Courts have not hesitated to dismiss Section 20(a) claims for failing to plead control adequately. *See, e.g.*, *Owens v. Gaffken & Barringer Fund, LLC*, No. 08 Civ. 8414, 2009 WL 3073338, at *12 (S.D.N.Y. Sept. 21, 2009); *In re Global Crossing*, 2005 WL 1907005, at *12-*13; *In re Deutsche Telekom AG Sec. Litig.*, No. 00 Civ. 9475, 2002 WL 244597, at *7 (S.D.N.Y. Feb. 20, 2002).

Commc'ns, Inc. v. Shaar Funds Ltd., 493 F.3d 87, 108 (2d Cir. 2007) (emphasis added). Since *ATSI*, nearly all of the decisions of this Court have held culpable participation is a required element of a claim under Section 20(a). *See, e.g.*, *Citiline Holdings, Inc. v. iStar Fin. Inc.*, No. 08 Civ. 3612, 2010 WL 1172647, at *8 (S.D.N.Y. Mar. 26, 2010).[13] The cases Plaintiffs cite for the proposition that culpable participation is not required pre-date *ATSI*. *See* Pls. Opp. at 57.[14]

Plaintiffs' allegations fall well short of pleading that PwCIL was a culpable participant in the Fairfield audits. Plaintiffs argue, without elaboration, that their allegations "sufficiently demonstrate that PwC International's conduct was highly reckless and unreasonable and represented a departure from standards of ordinary care." Pls. Opp. at 57. But the conclusory allegations put forth regarding PwCIL's purported culpability lack *any* factual support, much less the particularized facts required to plead a claim under Section 20(a). *See Kalin v. Xanboo, Inc.*, No. 04 Civ. 5931, 2009 WL 928279, at *12 (S.D.N.Y. Mar. 30, 2009); *Lapin v. Goldman Sachs Group, Inc.*, 506 F. Supp. 2d 221, 246 (S.D.N.Y. 2006); *In re Alstom*, 406 F. Supp. 2d at 491; *see also* PwCIL Mem. at 19-21. Plaintiffs' Section 20(a) claim should therefore be dismissed.

CONCLUSION

For the reasons stated above and in PwCIL's Memorandum, the claims against PwCIL in the Amended Complaint should be dismissed with prejudice.

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[13] *See also, e.g.*, *Hammerstone NV, Inc. v. Hoffman*, No. 09 CV 2685, 2010 WL 882887, at *11 (S.D.N.Y. Mar. 10, 2010); *Varghese*, 672 F. Supp. 2d at 611 (Marrero, J.); *Graham v. Barriger*, No. 08 Civ. 9357, 2009 WL 3852461, at *19 (S.D.N.Y. Nov. 17, 2009); *Ellington Mgmt. Group, LLC v. Ameriquest Mortgage Co.*, No. 09 Civ. 0416, 2009 WL 3170102, at *4 (S.D.N.Y. Sept. 29, 2009); *but see In re Parmalat Sec. Litig.*, 497 F. Supp. 2d 526, 532 n.42 (S.D.N.Y. 2007) (stating that the culpable participation requirement articulated in *ATSI* is dicta).

[14] The pre-*ATSI* case law, moreover, is mixed, with several decisions holding that a plaintiff bears the burden of pleading culpable participation as part of a *prima facie* case under Section 20(a). *See, e.g., In re Alstom*, 406 F. Supp. 2d at 491.

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Respectfully submitted,

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