IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

IN RE IKON OFFICE SOLUTIONS, INC. SECURITIES LITIGATION	:	**MDL DOCKET NO. 1318** **NO. 98-CV-4286 (MK)**

DEFENDANT ERNST & YOUNG LLP'S REPLY MEMORANDUM IN SUPPORT OF ITS MOTION FOR SUMMARY JUDGMENT

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TABLE OF CONTENTS

Page

PRELIMINARY STATEMENT 1

ARGUMENT 4

I. E&Y IS ENTITLED TO SUMMARY JUDGMENT BECAUSE PLAINTIFFS CANNOT ESTABLISH LOSS CAUSATION 4

A. Plaintiffs Misstate The Standard For Proof Of Loss Causation 5

B. Plaintiffs Fail To Show That Disclosures Relating To The Alleged Misrepresentations Caused The Stock Price To Decline 7

II. DESPITE ITS HEFT, PLAINTIFFS' RESPONSE CONTAINS NO EVIDENCE, MUCH LESS SUFFICIENT EVIDENCE, SHOWING THAT E&Y ACTED WITH SCIENTER 13

A. Plaintiffs Ignore The Governing Legal Standard 13

B. "Recklessness? We'll Prove A Knowing Misstatement!" 14

C. "Bulk Makes Right" 16

D. "Ratchet Up The Rhetoric" 20

E. "Because Our Experts Say So" 23

F. "Please Ignore The Arthur Andersen Evidence" 24

III. PLAINTIFFS CANNOT PREDICATE LIABILITY ON IKON'S OCTOBER 15, 1997 PRESS RELEASE 26

CONCLUSION 30

PRELIMINARY STATEMENT

You can tell a lot about plaintiffs' argument from the way they have structured their brief. As we explained in our opening memorandum, plaintiffs' case founders on the simple and straightforward fact that they cannot prove loss causation under this Circuit's decision in *Semerenko* v. *Cendant Corp.*, 223 F.3d 165 (3d Cir. 2000). Under *Semerenko*, plaintiffs must show that the drop in the price of IKON stock was the product of a "corrective disclosure" of the alleged fraud. But as we noted in our opening brief (at 10), and as plaintiffs are constrained to admit (Br. 61), the price of IKON stock did *not* drop, but rather *increased,* in the wake of the August 14, 1998 disclosure of the $110 million in charges. Now plaintiffs do, to be sure, attempt (unsuccessfully, as it turns out) to handle this fatal shortcoming in their case. But their evident lack of confidence in that response is reflected by their decision to bury it near the tail end of a 70-page brief, preceded by 49 pages of highly partisan, often wildly misleading factual assertions. The fact is, IKON's stock price did *not* decline in the wake of the August 14 disclosure; there is *no* evidence, much less sufficient evidence, that any *previous* decline in IKON stock price, or any decline *subsequent to August 17*, was caused by a "corrective disclosure"; and on that single ground alone, summary judgment is warranted.

How about those 49 pages of "facts"? Although this section of plaintiffs' brief is nominally devoted to the question of scienter, only a single footnote (and even then, a footnote to a section heading, see Br. 6 n.3) and a single line of text (see *id*. at 48) address the legal standard governing that crucial element. Again, the reason for this structural decision seems obvious enough. As we explained in our opening brief (at 26-30), in this Circuit and elsewhere the standard for scienter is extraordinarily high, requiring proof "of shoddy accounting practices amounting at best to a pretended audit or of grounds supporting a representation so flimsy as to lead to the conclusion that

there was no genuine belief back of it." *McLean* v. *Alexander*, 599 F.2d 1190, 1198 (3d Cir. 1979) (internal quotation marks and footnotes omitted). Plaintiffs do not dispute the standard, and they know how difficult that standard is to satisfy. So how do they go about trying to persuade the Court to send this element to a jury? In essence, plaintiffs adopt three strategies.

First, they lard their brief with hyperbole. Thus, for example, they recognize that they cannot prove scienter merely by showing that E&Y should have taken *more aggressive measures* to ensure that intercompany accounts were reconciled at year-end (a showing they cannot make in any event); plaintiffs therefore offer the more dramatic claim that "Ernst did absolutely nothing to make sure that intercompany accounts eliminated" (Br. 12) — an assertion for which they offer (and can offer) no support at all. They also punctuate their claims with a series of harsh adjectives, evidently believing that colorful language can substitute for actual proof. Thus, for example, E&Y auditors don't make "errors," they make "inexplicable errors" (*id*. at 2); they don't breach their duties, they commit "startling dereliction[s] of duty" (*id*. at 3); they don't make judgments with which plaintiffs' experts simply disagree, they "invent" "phony" (*id*. at 41) and "bogus" (*id*. at 3) sums of money, they "engage[] in * * * convoluted accounting manipulations" (*id*. at 7), and, of course, they embark in that time-tested plaintiff's metaphor, "an attempted cover-up" (*ibid*.).

Plaintiffs' second device consists of stringing together page after page of record citations, all in the hope that bulk will substitute for content. But as the courts have made clear, time and again, "[n]either sheer bulk nor the existence of a disputed fact of one kind or another necessarily suffices to defeat a summary judgment motion." *Moore* v. *Nutrasweet Co.*, 836 F. Supp. 1387, 1390 (N.D. Ill. 1993) (citation omitted).

Finally, and perhaps most tellingly, plaintiffs make the brazen claim that they can prove not only *recklessness* (an extraordinarily high threshold in its own right), but, at least as to $20,867,000

of the supposed overstatement, an outright *knowing* violation. Br. 8-21. It's a classic rhetorical device: "What do you mean we can't prove *recklessness*; we can prove *deliberate falsehood*!" But as we show below, plaintiffs either do not understand, or do not wish to share with the Court, what it means under the case law to commit a "knowing" misstatement of material fact. Plaintiffs seem to believe that an auditor commits a "knowing" violation if he "knows" of any relevant fact and then makes an auditing judgment, somehow related to that known fact, with which plaintiffs' experts disagree. That is of course not the law. A "knowing" misstatement under Rule 10(b) is a deliberate falsehood — a statement that the auditor knows to be false at the very instant he makes it. Plaintiffs have no such evidence, and they have no business suggesting otherwise.

As for plaintiffs' claim that E&Y "approved" IKON's October 15, 1997 earnings release — and may therefore be held liable under Section 10(b) for any misstatement contained in that release — the law is flatly to the contrary. As the Supreme Court's decision in *Central Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), makes clear, auditors cannot be held liable for "aiding and abetting" the purported misstatements of their clients. Yet that is exactly what plaintiffs ask this Court to permit. Doing so would run afoul not only of *Central Bank* but also the great weight of case law — including decisions from two district courts in this Circuit — that has developed since *Central Bank*. Accordingly, in the event the Court does not grant summary judgment in its entirety, it should at a minimum grant judgment with respect to all claims based upon the acquisition of IKON stock prior to December 24, 1997, the date on which E&Y's audit report was issued.

ARGUMENT

I. E&Y IS ENTITLED TO SUMMARY JUDGMENT BECAUSE PLAINTIFFS CANNOT ESTABLISH LOSS CAUSATION

Our opening brief exposes a fatal infirmity in plaintiffs' claims: because IKON's stock price did not fall (and in fact *rose*) after the company disclosed its intention to book $110 million in accounting charges, there is no basis to conclude that the alleged $54.9 million overstatement of income in IKON's 1997 financial statements caused plaintiffs any harm. There is no dispute about the basic facts: as plaintiffs' experts are constrained to acknowledge, the precipitous drop in the price of IKON stock occurred between April 22 and August 13, 1998, the day *before* the disclosure of the $110 million in charges. See Jarrell Rpt. ¶¶ 44, 55. Nor is there any dispute that the pre-August 14 stock declines resulted, not from any announcement expressly relating to the accounting issues underlying the charges, but rather — as plaintiffs' expert R. Alan Miller conceded — from "repeated announcements of lower *operating earnings* than were expected by the investment community." Miller Rpt. ¶ 37 (emphasis added). And no one, not even plaintiffs' experts, has suggested that IKON's disappointing 1998 operating performance would have been either better or worse had IKON shown $54.9 million less income on its books at year-end 1997. Accordingly, there simply is no cause-and-effect relationship between the alleged corrective disclosure and the stock's earlier decline, and thus there is no claim under Section 10(b).

Forced to concede that the market did not react negatively to the August 14th disclosure, plaintiffs seek to prove causation by relying on dueling — indeed, logically irreconcilable — loss scenarios trumped up by their damages experts. They first contend, citing *one* of their damages experts (with whom the other disagrees), that the market fully absorbed the impact of the alleged misrepresentations *before* IKON announced its intention to take the $110 million accounting charge.

Next, citing their *second* damages expert, plaintiffs contend that exactly the opposite is true: that the market, although "slightly relieved" immediately after the August 14th announcement, and having not received any new information related to the matters at issue, inexplicably reconsidered its initial positive reaction and began to bid the stock price down. As a third alternative, plaintiffs posit that it is "impossible" to discern *what* the market thought about the disclosure of the accounting charges, because the good news included in the August 14th announcement *might* have counteracted the bad news about the accounting changes.

Plaintiffs' dueling theories of loss causation, resting on contradictory expert opinions, cannot fill the gaping hole in their proof. They have adduced *no evidence whatsoever* that the stock price "dropped *in response to the disclosure of the alleged misrepresentations*." *Semerenko*, 223 F.3d at 186 (emphasis added). Because plaintiffs fail to adduce the key evidence necessary to establish loss causation, no reasonable jury could conclude that plaintiffs were harmed by the misrepresentations that they allege, and E&Y is entitled to summary judgment.

A. Plaintiffs Misstate The Standard For Proof Of Loss Causation

In an effort to avoid the entry of summary judgment, plaintiffs first attempt to water down the showing that they must make to demonstrate loss causation. They concede generally that they must show not only that they lost money after purchasing stocks at an inflated price, but also that the misrepresentation alleged to have caused the price inflation "was in some reasonably direct, or proximate, way responsible for [the] loss." *Robbins* v. *Koger Properties, Inc.*, 116 F.3d 1441, 1447 (11th Cir. 1997) (quoting *Huddleston* v. *Herman & MacLean*, 640 F.2d 534, 549 (5th Cir. 1981)); see also Br. 55 ("a plaintiff must show not only the purchase of * * * a security at an inflated price, but also that the misrepresentation proximately caused the decline in the security's value"). Although they thus pay lip service to the loss causation requirement, they suggest that a claimant

can meet that requirement "simply by showing that he or she purchased a security at a market price that was artificially inflated due to a fraudulent misrepresentation" (*id.* at 54), and that the stock price thereafter dropped (*id.* at 55). That description, of course, omits the lynchpin of the loss causation showing – a demonstration that the stock price "dropped *in response* to the disclosure of the alleged misrepresentations." *Semerenko*, 223 F.3d at 186 (emphasis added); see also *Robbins*, 116 F.3d at 1448 ("Our decisions implicitly require proof of a causal connection between the misrepresentation and the investment's subsequent decline in value.").

Robbins demonstrates that it is crucial to show a substantive connection between the loss-causing disclosures and the alleged misrepresentations. Plaintiffs there contended that they had paid too much for Koger stock because of fraudulent misrepresentations in the company's audited financial statements, and they demonstrated that they had suffered losses when the price of the stock fell dramatically. 113 F.3d at 1445. However, the stock price fell *before* the fraud was disclosed, at a time when "the investing public continued to believe that [Koger's] * * * cash flow figures were correct and that [it] would not have to adjust its balance sheet to cover any past errors." *Id.* at 1448. Because plaintiffs had failed to prove that disclosures *relating to the prior misrepresentations* caused the decline in the stock price, the court ruled that there was "no evidence" that the alleged misrepresentations were "a substantial cause" of plaintiffs' harm, and reversed the jury's verdict in plaintiffs' favor. *Id.* at 1448-49.

As we demonstrated in our opening brief, *Robbins* is dispositive here. Plaintiffs attempt to distinguish *Robbins* from this case by arguing that, there, plaintiffs "did not present evidence that the artificial inflation was removed from the market price of [Koger] stock, thereby causing a loss." Br. 56 (citing *Robbins*, 116 F.3d at 1446). They contend that, "[h]ere, the cost of the misrepresentation is ***not*** still incorporated into the value of the IKON stock, and, consequently, it

may ***not*** simply be recovered by selling the stock at the inflated price." Br. 55. But that argument misses the point of *Robbins*. As the court stated in *Robbins*, "[p]roof of damages * * * is not proof of loss causation" (116 F.3d at 1447 n.5); "loss causation and damages * * * involv[e] * * * discrete inquiries." *Ibid.* In *Robbins* – just as in this case – there was a decline in the inflated stock price *before* the revelations concerning the alleged misrepresentations. Accordingly, in *Robbins* – just as in this case – plaintiffs' loss could not be causally tied to the alleged misrepresentations.

B. Plaintiffs Fail To Show That Disclosures Relating To The Alleged Misrepresentations Caused The Stock Price To Decline

It is obvious why plaintiffs elide the crucial element of loss causation: they cannot show that the price of IKON stock dropped in response to disclosure of the alleged misrepresentations. As we explained in our opening brief, under plaintiffs' theory of their case, IKON's announcement on August 14th, 1998, that its second and third quarter earnings required a collective adjustment of $110 million disclosed a $54.9 million flaw in IKON's 1997 audited financial statements. See 2d Am. Cplt. ¶ 100 ("the Company's restatement of previously reported financial statements as a result of admitted accounting errors and irregularities is a further admission that IKON's publicly reported financial results had been misstated"). However, contrary to the contention in plaintiffs' supplemental pretrial memorandum that "[a]fter the August 14, 1998 disclosure, the market price of IKON stock" dropped and has never recovered (*id.* at 3), the price of IKON stock actually *rose* after the August 14th disclosure. Because the alleged misrepresentations clearly did not cause plaintiffs' losses, they cannot recover under Rule 10b-5.

1. Implicitly acknowledging the flaws in their case, plaintiffs struggle to show that the events that *did* cause IKON's stock price to fall were somehow related to the misrepresentations. Abandoning their prior focus on the August 14th disclosure, they now contend that "virtually all of

the artificial inflation was corrected by partial disclosures beginning in April 1998." Br. 55. This belated effort to show loss causation fails completely.

To begin with, plaintiffs' suggestion that the alleged artificial inflation was "corrected" *before* August 14th is directly contradicted by the opinion of one of their two damages experts, who testified that "the information disclosed on August 14th had *not* been anticipated by the market." Miller Tr. 431 (emphasis added); see also Affidavit of R. Alan Miller ¶ 19 (Ex. A to Pl. Opp. to Motion *in limine* to Exclude Irrelevant and Inadmissible Damage Estimates) (arguing that there was a "decline in stock price which occurred *after* the August 14, 1998 announcement") (emphasis added).

In any event, as we demonstrated in our opening brief (at 14-16), there is not a stitch of evidence that any of the "partial disclosures" upon which plaintiffs rely in their brief were related to the misrepresentations. Plaintiffs do not contend that those pre-August 14th disclosures revealed the substance of alleged accounting problems with IKON's financial statements. Instead, they assert that the disclosures and the alleged misrepresentations all "touch upon" the same issue – which they characterize as "lower than expected earnings." Br. 56. But plaintiffs' unsupported contention that the alleged misrepresentation in E&Y's 1997 audit report *also* tangentially relates to the general subject of "lower than expected earnings" does not establish loss causation. The cases require a much more direct relationship between the misrepresentations and plaintiffs' losses.

In *Huddleston* v. *Herman & MacLean*, 640 F.2d 534, 549 (5th Cir. 1981), *aff'd in part, rev'd in part on other grounds*, 459 U.S. 375 (1983) – the decision from which the phrase "touch upon" is drawn – the court made it clear that there must be a close causal connection between the misrepresentation and the loss:

> The plaintiff must prove * * * that * * * the untruth was in some *reasonably direct, or proximate, way responsible for his loss*. The causation requirement is satisfied in a Rule 10b-5 case only if the misrepresentation *touches upon the reasons for the investment's decline in value*. If the investment decision is induced by misstatements or omissions that are material and that were relied upon by the claimant, but are not the proximate reasons for his pecuniary loss, recovery under the Rule is not permitted.

Id. at 549 (emphasis added). *Robbins* gives flesh to this standard, and establishes that there must be a direct and specific relationship between the misrepresentation and the decline in the stock price. In *Robbins*, plaintiffs contended that they purchased stock at an inflated price because of misrepresentations in Koger's financial statements, but the stock price fell after a cut in dividends. In an effort to demonstrate a nexus between the inflation of the stock price and the alleged fraud, plaintiffs' expert testified that Koger "would have had to cut its dividends at the beginning of the class period had [its] financial statements been corrected to eliminate the incorrect statements of cash flow." 116 F.3d at 1445. Although both the misstatements in the financial statements and the dividend reduction could have been characterized as relating to Koger's cash flow, the court found "misplaced" the "attempt to characterize this testimony as proof of loss causation." *Id.* at 1448 n.6. Because the market was unaware of the past errors in Koger's balance sheet when the stock price fell, the court ruled that plaintiffs had not demonstrated loss causation.

Here, the disclosures that triggered reductions in IKON's stock price were totally unrelated to the alleged misrepresentations. As we explained in our opening brief (at 14-16), the disclosures between April 22 and August 13 upon which plaintiffs rely concerned IKON's operating performance, and did not foreshadow that IKON would be taking accounting charges. Although plaintiffs take us to task for "ignoring" the contrary opinions of their damages experts (Br. 55), they make no effort to refute the detailed showing in our opening brief (at 19-24) that the experts had *no evidence* that the news of the special charges leaked into the market before August 14th.

Indeed, plaintiffs' discussion of the facts confirms our point. Concerning the April disclosure, for example, they cite the testimony of Dr. Jarrell that the market then "learned * * * that the company was having operational problems with, among other things, managing and getting the synergistic benefits and integrating these many, many companies that they had been acquiring as part of their business strategy." Br. 59 (quoting Jarrell Tr. at 37-38). As we explained, these were problems that the company encountered in 1998, having nothing to do with the $110 million in *accounting* charges, which related primarily to lease default reserves, accounts receivable reserves, and internal control deficiencies. Regarding disclosures later in the class period concerning IKON's decreasing operating earnings, the most plaintiffs can say is that the market "knew that something was wrong." Br. 59-60. If that were enough to establish a relationship between a fraudulent statement and a later, loss-causing event, then *any* negative news could be said to relate to an earlier misstatement – and "Rule 10b-5 would become an insurance plan for the cost of every security purchased in reliance upon a material misstatement or omission." *Huddleston*, 640 F.2d at 549.

Revealing their understanding of the weakness of their showing of causation, plaintiffs argue that requiring a closer nexus between the loss-causing disclosures and the alleged fraud "would serve to bar liability under the Exchange Act except in the implausible situation where a defendant specifically stated in a disclosure that it had committed a fraud, and where it identified the specifics of the fraud." Br. 60. That is nonsense. There is no dispute that the August 14th disclosure — which hardly constitutes an admission of fraud — was specifically addressed to the supposed misrepresentations that plaintiffs contend inflated the purchase price of the stock. The fact that the market was unconcerned about that particular disclosure does not mean that E&Y has posited an insurmountable standard for proving proximate causation. It simply means that plaintiffs' losses *were not caused* by the alleged misrepresentations that underlie their claims.

2. Having first argued that loss causation is established because the market anticipated and fully absorbed the effect of the "corrective disclosure" *prior* to August 14, 1998, plaintiffs then turn to their second expert, Mr. Miller, and argue in the alternative that loss causation is shown by the market's reaction *after* August 14. Plaintiffs do not dispute that the stock price *rose* in the immediate wake of the August 14th announcement; indeed, they now say that the market was "relieved" by the news. Br. 61. But they nonetheless contend that the stock price *later* fell in response to the August 14th announcement. Plaintiffs proffer no evidence to support their illogical and self-contradictory argument, and it cannot defeat summary judgment.

Plaintiffs have alleged that the "market for IKON securities was at all times an efficient market," and that, accordingly, "[t]he market price of IKON securities reacted efficiently to new information entering the market." 2d Am. Cplt. ¶ 15. If that is true — and, if it is not, then plaintiffs cannot rely on the fraud on the market theory — then it must be presumed that the market absorbed and processed the information in the August 14th announcement as soon as it was released. Plaintiffs' expert Dr. Jarrell apparently recognized this; that is why, to explain the market's failure to react to the August 14th announcement, he was forced to opine that "when the charges were announced, it was clear in my opinion that the stock market had completely anticipated * * * the material charges that were taken." Br. 61 n. 28 (quoting Jarrell Tr. at 74); see also *id.* at 124-125 (agreeing that "to the extent there was a statistically significant adverse price reaction to the information contained in the August 14 announcement, it all occurred *prior* to August 14") (emphasis added).

Again breezily contradicting their own expert's opinion, plaintiffs contend that they have "adduced evidence that the price of IKON common stock actually did decline even further in reaction to the August 14, 1998 announcement." Br. 63. But the only evidence they cite is the

opinion of their *other* expert, Mr. Miller, that the stock's decline over the next several weeks was "among other things," a reaction to the August 14th announcement. *Ibid.*[1] The conclusory assertion of an expert witness is insufficient to create an issue of triable fact defeating summary judgment. *Rebel Oil Co* v. *Atlantic Richfield Co.*, 51 F.3d 1421, 1440 (9th Cir. 1995) ("When the expert opinion is not supported by sufficient facts to validate it in the eyes of the law * * * summary judgment is appropriate"). That is especially clear here, where the expert's *ipse dixit* both flouts universally accepted rules concerning the behavior of efficient markets and directly contradicts the opinion of another expert hired by the same party to testify on the same issue.

3. In a final effort to avoid summary judgment, plaintiffs throw out the suggestion that we can conclude *nothing* from the markets' failure to react on August 14th. They contend that "positive elements" in the August 14th announcement may have counteracted a negative response to the disclosure of the accounting charges, and that it is "impossible to separate out" the effects of the good and bad news. Br. 62. That observation does not defeat our motion for summary judgment, however. It is *plaintiffs' burden* to establish loss causation, and they offer no evidence whatsoever to demonstrate that, in the absence of the "good news" in the August 14th disclosure, the stock price actually would have gone down. Indeed, plaintiff's new theory only confirms that the claim that the August 14th disclosure caused harm is entirely speculative, and thus fails the test of loss causation set forth in *Robbins*.

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[1] Miller's conclusion regarding post-August 14th price effects is entitled to little weight, given that he performed no regression analysis (see Miller Tr. 429) to determine what part, if any, of the post-August 14th price movement was causally linked to the August 14th disclosure. An "event study" is "fatally deficient" where (as here) it makes no attempt "to remove the effects on stock price of market and industry information." *In re Northern Telecom Ltd. Securities Litig.*, 116 F. Supp.2d 446, 460 (S.D.N.Y. Sept. 28, 2000); *In re Executive Telecard, Ltd. Securities Litig.*, 979 F. Supp. 1021, 1026 (S.D.N.Y. 1997) (same).

II. DESPITE ITS HEFT, PLAINTIFFS' RESPONSE CONTAINS NO EVIDENCE, MUCH LESS SUFFICIENT EVIDENCE, SHOWING THAT E&Y ACTED WITH SCIENTER

A. Plaintiffs Ignore The Governing Legal Standard

Because they try so hard to obscure the point, it is worth stating, once again, the governing standard for proving scienter in a Section 10(b) case: Scienter under Section 10(b) is "a mental state embracing an intent to deceive, manipulate, or defraud." *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 193 n.12 (1976). It may be proved either by showing a "knowing" misstatement — which requires proof that the auditor "had 'actual knowledge' of a misrepresentation" (*In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1426 (9th Cir. 1994)), that is to say, the auditor made a deliberate falsehood — or by showing recklessness. To prove recklessness, plaintiffs must make a "showing of shoddy accounting practices amounting at best to a pretended audit or of grounds supporting a representation so flimsy as to lead to the conclusion that there was no genuine belief back of it." *McLean*, 599 F.2d at 1198. Put another way, "recklessness" requires plaintiffs to "prove that the accounting practices were so deficient that the audit amounted to no audit at all * * * or that the accounting judgments were such that *no reasonable accountant would have made the same decisions if confronted with the same facts*." *Worlds of Wonder Sec.*, 35 F.3d at 1426 (emphasis added) (internal quotations omitted).

This is a high bar indeed. Plaintiffs cannot prevail merely by showing that E&Y should have conducted the audit differently. Even "gross, grave or inexcusable negligence" is not sufficient to establish scienter. *McLean*, 599 F.2d at 1198. Moreover, plaintiffs must show more than that the financial statements violated GAAP, or that E&Y violated professional standards. "Allegations of violations of GAAP provisions * * * without corresponding fraudulent intent [] are not sufficient to state a securities fraud claim." *Chill* v. *General Elec. Corp.*, 103 F.3d 263, 270 (1996). See also

Worlds of Wonder, 35 F.3d at 1426 (allegations of violations of GAAS insufficient to establish scienter).

Significantly, plaintiffs do not take issue with the legal standard. Nor do plaintiffs dispute that, to meet that standard, they must show more than simply isolated instances of reckless conduct. Have they adduced the requisite evidence? Not even close. In their entire 43-page section nominally devoted to the scienter issue, they provide not a single fact or combination of facts that rises to the extraordinary threshold required to prove scienter. Nor have they cited a single case in which a jury was permitted to rest a scienter finding on the kinds of highly judgmental differences of opinion at issue in this case. Instead, they trot out five tried-and-true litigation tactics, designed to persuade this Court — despite all the evidence to the contrary — to send this case to the jury. For simplicity's sake, we might call these tactics: (1) "Recklessness? We'll prove a knowing misstatement!"; (2) "Bulk makes right"; (3) "Ratchet up the rhetoric"; (4) "Because our experts say so"; and (5) "Please ignore the Arthur Andersen evidence." None of these tactics, however, creates a genuine issue of material fact.

B. "Recklessness? We'll Prove A Knowing Misstatement!"

Perhaps on the premise that the best defense is a strong offense, plaintiffs begin their effort to show recklessness by proclaiming that, in point of fact, they can actually make the even more extraordinary showing of a "knowing" misstatement. Plaintiffs' theory appears to be that because E&Y "knew" of certain putative errors in IKON's 1997 financial statements, which they claim totaled $20,867,000 in all, then E&Y must have "knowingly" issued a false audit opinion on those financial statements. Br. 8-9.

It is best to put this canard to rest right at the outset. In the first place, the evidence does not support the assertion that E&Y "knew" of the various "errors" that plaintiffs catalog in their

opposition. Br. 8-21. The most notable of these is plaintiffs' allegation that E&Y "knew" that there was an unrecorded charge of $4 million for out-of-balance intercompany accounts. *Id*. at 12. The evidence cited in support of this contention shows, at the most, that E&Y was aware of a risk that intercompany accounts might not eliminate. It does not show, or even create a fair inference, that E&Y *knew* that the financial statements contained over $4 million in errors.[2]

Even assuming, however, that E&Y knew of some "errors" in particular accounts or balances, "knowledge" of such intermediate facts does not mean that E&Y acted "knowingly" within the meaning of the case law. To act knowingly, an auditor must know that its *audit opinion* is false; it is not enough simply to "know" some underlying facts that might cause the financial statements to be misstated. "In order to establish intentional deception, a plaintiff must do more than show that the defendant had knowledge of the undisclosed facts." *Danis* v. *USN Communications, Inc.*, No. 98 C 7482, 2000 WL 1700126, at *7 (N.D. Ill. Nov. 13, 2000). Granting summary judgment for the auditing firm Deloitte & Touche, the court in *Danis* explained that "plaintiffs contend that Deloitte knew about the misrepresentations in USN's financial statements because Deloitte knew about problems in USN's operational systems. * * * Even if this knowledge could be established, it would merely support an inference of negligence." *Id*. at *8. See also *Worlds of Wonder*, 35 F.3d at 1426 ("Deloitte knew many facts because it did a diligent audit. But the issue is not whether Deloitte knew facts about transactions; it is whether Deloitte had 'actual knowledge' of a misrepresentation * * *."); *Schlifke* v. *Seafirst Corp.*, 866 F.2d 935, 946 (7th Cir. 1989) (with regard to establishing scienter, "[t]he question is not whether the [defendant] had

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[2] As is their wont, plaintiffs have cited selectively to the evidence; the record does not support any conclusion other than the conclusion that balances classified as "intercompany" did in fact eliminate. See Sec. II.C, *infra*.

knowledge of the undisclosed facts"). You can search plaintiffs' brief from beginning to end and you won't find a single drop of evidence suggesting that E&Y "had 'actual knowledge' of a misrepresentation."

C. "**Bulk Makes Right**"

Plaintiffs' next tactic is to write more pages of "facts" — and attach more pages of exhibits — than Carter has little liver pills. Much like the popular placebos, however, plaintiffs' bulky submission does not cure the underlying problem. None of the "facts" relied on by plaintiffs *raises* an inference of scienter; most, in fact, *negate* any such inference.

Indeed, it is striking, as one reads plaintiffs' brief, to note the many instances in which the very evidence they cite, far from showing a "pretended audit," shows the exact converse — a thorough audit, performed by diligent professionals, in which interim steps en route to carefully considered judgments are now turned against E&Y as evidence of supposed "scienter." For example, plaintiffs discuss numerous early estimates or judgments made by E&Y auditors at the Southern District and the Southern California marketplace during interim procedures, and then profess disagreement with E&Y's ultimate resolution of these issues at year end. Br. 17-19, 22-26; see also Br. 33-34 (discussing audit reconciliation adjustments). But how, exactly, does that show a "pretended audit?" If anything, it shows field auditors who identified certain issues, advised their colleagues at the corporate level, and enabled E&Y corporate to evaluate the issues. Or, to take an example from the Special Procedures, plaintiffs maintain that Alan Lilholt, another E&Y partner who worked on the Special Procedures, "found" that a reserve of $3.4 million was "needed" in IKON's Carolina/Virginia District, and that "there is simply no support" for E&Y corporate's "improper reduction of a carefully documented finding." Br. 42-43. But as Alan Lilholt himself explained to plaintiffs at his deposition, his intent during the field work "was to give a first pass"

of his estimate "to E&Y corporate, who might have more information" and "could cause these numbers to change." Lilholt Tr. 151 (Ex. 40).[3] Where is the "recklessness" in any of that? Does it sound even remotely like the kinds of records on which juries have in previous cases been permitted to find scienter?

Likewise, plaintiffs acknowledge that E&Y's field auditors in Northern California performed substantial additional work at that district in 1997, but they quibble over how particular procedures should have been performed. Br. 26-33. But again, there is no way to call any of this a "pretended audit." It is, instead, a picture of a firm grappling with complex, technical issues, analyzing them at both a local and consolidated level, and reaching appropriate judgments. To our knowledge, no case has ever been sent to a jury on a record like this, and plaintiffs certainly do not point to any.

As for plaintiffs' complaint that certain work — notably, analysis of intercompany accounts, accounts receivable, and lease default reserves on a consolidated basis — must not have been sufficient because they cannot find the applicable work papers, that too is a makeweight. In the first place, as often as not the problem is plaintiffs' own inability to locate the relevant work papers. For example, plaintiffs contend that there are no work papers showing that E&Y analyzed IKON's accounts receivable reserve on a consolidated basis. Br. 11-12, 48. In fact, there are such work papers — and plaintiffs ought to know it. Carmen Nepa, the Senior Manager on the IKON audit, identified such work papers for plaintiffs at his deposition. Nepa Tr. 532-40; see also EY 035337-43 (Ex. 81); EY 021378-87 (Ex. 82). More fundamentally, however, as we established in our opening

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[3] All references to exhibits that can be found in the Appendix to Defendant Ernst & Young's LLP's Motion for Summary Judgment are designated as "Ex." Concurrently with this memorandum, we are filing Volume IX of this appendix, which includes all documents not referenced in our opening memorandum or in plaintiffs' opposition. All references to exhibits found in Plaintiffs' Appendix of Exhibits to Memorandum in Opposition to Ernst & Young's Motion for Summary Judgment are designated "Pl. Ex."

memorandum (at 26-30), mere disagreements with judgments made by auditors — including about such quintessentially discretionary matters as the extent to which procedures should be documented — are insufficient to establish scienter. See *Worlds of Wonder*, 35 F.3d at 1427 ("[Plaintiffs' expert's] declaration consists of self-righteous statements that, because Deloitte did not audit [the company] as he would have done, Deloitte must have acted fraudulently. Such evidence is not sufficient.").

To be sure, plaintiffs' filing does give the impression of heft. But bulk alone, it goes without saying, cannot defeat summary judgment.[4] The crucial question is not whether there is "evidence" in the case, but whether that evidence is of such a "quality" and "caliber" to support a jury verdict that E&Y acted recklessly. See *Anderson* v. *Liberty Lobby, Inc.*, 477 U.S. 242, 254 (1986) (no genuine issue of material fact if evidence "is of insufficient caliber"); *Collier* v. *City of Chicopee*, 158 F.3d 601, 604 (1st Cir. 1998) (issue of material fact must be "shown by resort to materials of a suitable evidentiary quality") (internal quotation marks omitted), *cert. denied*, 526 U.S. 1023 (1999); *Powell* v. *Haverty Furniture Companies, Inc.*, 912 F. Supp. 532, 535 (M.D. Ga. 1996) ("the evidence must be of such a quality that a reasonable jury could return a verdict for the nonmoving party"). Here, the evidence, taken singly or together, simply does not prove recklessness.

To the contrary, as we have noted, the undisputed record in this case affirmatively *disproves* (as if it were our burden of proof) the proposition that E&Y's work "amounted to no audit at all."

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[4] "Neither sheer bulk, nor the existence of a disputed fact of one kind or another necessarily suffices to defeat a summary judgment motion, for a 'genuine' issue does not exists unless record evidence would permit a reasonable factfinder to adopt the nonmovant's view." *Moore* v. *Nutrasweet*, 836 F. Supp. at 1390 (granting summary judgment); see also *Ridgewood Bd. of Education* v. *N.E. ex rel. M.E.*, 172 F.3d 238, 252 (3d Cir. 1999) ("Speculation and conclusory allegations" insufficient to defeat summary judgment) (internal citations omitted); *Local Union 7107* v. *Clinchfield Coal Co.*, 124 F.3d 639, 640 (4th Cir. 1997) ("Fanciful inferences and bald speculations * * * need not be drawn or engaged in at summary judgment.").

To our knowledge, there is no case — and plaintiffs certainly don't cite any — in which a trial court has ever permitted a jury to find recklessness on a record like this one, involving months of audit planning, more than 10,000 hours of work, and a re-examination of the financial statements at issue by a second prominent accounting firm. Indeed, just last week, the United States District Court for the Northern District of Illinois granted summary judgment for the accounting firm of Deloitte & Touche where the firm devoted 1200 hours — a mere fraction of the work done here — to the audit at issue. The court held that the 1200 hours of work "alone defeats a claim of recklessness." *Danis*, 2000 WL 1700126, at *9. Thus, although it may sometimes be true that scienter is a "fact-intensive inquiry" (Br. 48), that is no excuse for asking this Court, as plaintiffs do (albeit *sotto voce*), to punt this issue to the jury. Were that a permissible approach, there would be no way to account for the numerous cases cited in our opening memorandum (at 29-30) — none of which plaintiffs address, much less distinguish — in which summary judgment was granted in favor of auditors in cases brought under Section 10(b). See, *e.g.*, *Worlds of Wonder*, 35 F.3d at 1407 (affirming grant of summary judgment where plaintiffs showed nothing more than a misapplication of accounting principles); *Wells* v. *Monarch Capital Corp.*, No. 91-10575-ADM, 1996 WL 728125, at *16 (D. Mass. Oct. 22 1996), *aff'd per curiam*, 129 F.3d 1253 (1st Cir. 1997) ("The summary judgment record fails to show that [defendant] acted intentionally or recklessly to defraud the investing public in issuing its March 1990 audit opinion."). As in those cases, summary judgment is appropriate here, as plaintiffs have not demonstrated facts (rather than speculation or conjecture) that create a genuine issue as to the question of scienter.

D. "Ratchet Up The Rhetoric"

Recognizing, it seems, that facts wholly unrelated to scienter will not carry their burden, plaintiffs resort to unwarranted hyperbole. Thus they claim that E&Y "blatantly violated" professional standards (Br. 11) and "completely disregarded" its audit findings (*id.* at 18). In repeated instances plaintiffs' attempt to dramatize the evidence leads them to misstate the facts. Thus, for example, plaintiffs claim that E&Y did "absolutely nothing" to test intercompany accounts. Br. 12. In truth, however, the record is replete with uncontradicted testimony and references to work papers showing that work was done during the 1997 audit to ensure that intercompany accounts eliminated on a consolidated basis. Mulherin Tr. 458 (Ex. 39); Mulherin Decl. ¶ 26 (Ex. A); Nepa Tr. 593-604 (Ex. 29); EY035004-31 (Ex. 80). Similarly, plaintiffs assert that E&Y did not evaluate lease default reserves on a consolidated basis. Br. 17-18. But again, the record includes both testimony and documentation showing that E&Y performed such an analysis. EY 101642-46 (Ex. 83); Mulherin Tr. 149-52, 177-78; Nepa Tr. 550-553.

But perhaps the most egregious of plaintiffs' allegations is their claim that E&Y engaged in "a transparent, blatant cover up" during the Special Procedures "aimed at avoiding a restatement of the 1997 financial statements." (Br. 44.) Plaintiffs' characterization of E&Y's conduct during the Special Procedures as a "cover up" has no foundation in the record, and addressing a few of their allegations confirms this point.

For example, plaintiffs claim that E&Y was put on notice that IKON personnel had complained of "being instructed to perform unnatural acts." Br. 37-38. Plaintiffs neglect to mention, however, that when George Berry, E&Y's coordinating partner for the IKON engagement, learned of this and other allegations by IKON personnel, he advised the company to have its lawyers investigate them — and IKON took that advice. Berry Tr. 16-20 (Ex. 15). Plaintiffs also fail to

mention that Mike Royce, the CFO of IKON's Northern California district, testified that he was most likely the "author" of this statement, that it was taken "totally out of context," and that the "unnatural act" was requiring his staff to "work any more than they're already working." Royce Dep. 358 (Ex. 31).

Similarly, plaintiffs allege that E&Y was aware that IKON's CFO had been accused of cooking the books (Br. 38). Yet they fail to complete the story and inform the Court that — as plaintiffs themselves have admitted — an independent law firm investigating this allegation informed George Berry that "there was nothing to the 'cooking the books' allegations." Response to Request for Admission No. 45 (Ex. 79). Nor do they bother to tell the Court that Peter Shoemaker — the former IKON official who supposedly made the "cooking the books" allegation — has flatly denied ever making such an allegation, ever believing such a thing, or even having ever had a basis for believing any such thing. Shoemaker Tr. (8/22/00) 7-22 (Ex. 14).[5]

Finally, plaintiffs argue that E&Y somehow "invented" a "phony" adjustment to IKON's inventory reserve, and did so by "changing" the recommendations of E&Y auditors working at various IKON field locations. Br. 41-43. Plaintiffs seem to assume that the numbers submitted by the "field" would never be challenged, examined, or modified — an assumption belied by all of the evidence. Every E&Y and IKON witness involved in the Special Procedures explained to the

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[5] In our opening brief (at 2), we explained that discovery has confirmed that Mr. Shoemaker made whatever remark he made fully nine days *after* IKON's Registration Statement became effective — in direct contravention of plaintiffs' contention, in opposition to our motion to dismiss, that George Berry "learned" of Shoemaker's remarks *before* the effective date of the Registration Statement. Plaintiffs glide past this telling detail with the simple declaration that "[f]or some reason, Ernst complains at length that the case plaintiffs will take to the jury is somewhat streamlined from that which plaintiffs pled against Ernst." Br. 5. Our "complaint," of course, has nothing to do with the "streamlined" nature of plaintiffs' current "case"; it is, instead, with the fact that plaintiffs persist, even now, in misstating the record, exaggerating claims, omitting key facts, and taking other unfortunate liberties in an effort to get this case to a jury.

plaintiffs during deposition that the work done by the field auditors was always intended to be reviewed at the corporate level to see if the results made sense in the overall, consolidated context. Arthur Andersen understood this as well; the two principal Andersen partners who worked on the Special Procedures explained during deposition that decisions about the inventory reserve had been made at the corporate level, and that there was a "very good possibility" that the final numbers were different than the final submissions from the field. Costello Tr. 130 (Ex. 23); see also McAleer Tr. 75 (Ex. 22). It defies credibility to suggest, as plaintiffs do, that Andersen, which was hired to represent interests other than E&Y's, would countenance the invention of a "phony" adjustment for inventory reserve.

In any event, plaintiffs' claim of a "cover up" during the *1998* Special Procedures is hardly probative of E&Y's state of mind at the time of the *1997* year-end audit. See, *e.g.*, *Weber* v. *Contempo Colours, Inc.*, 105 F. Supp. 2d 769, 773 (W.D. Mich. 2000) (plaintiff had not alleged scienter where complaint did not support the conclusion that the defendant knew the challenged statement was false at the time he made it); *Reiger* v. *Altris Software*, No. 98-CV-528, 1999 WL 540893, at *9 (S.D. Cal. Apr. 30, 1999) ("[A] statement's falsity, even if profound, does not raise an inference of scienter on the part of an auditor absent circumstances indicating that the auditor must have been aware of the falsity at the time the statements were made."). It goes without saying that, for scienter purposes, all that matters is E&Y's state of mind in 1997. Plaintiffs are not entitled to leap from E&Y's alleged state of mind in the summer of *1998* to E&Y's state of mind in late *1997*. See Fed. R. Evid. 404(a) ("Evidence of a person's character or a trait of character is not admissible for the purpose of proving action in conformity therewith on a particular occasion * * * .").

E. "Because Our Experts Say So"

Plaintiffs' next stab at establishing recklessness is the proffer of expert opinions having no basis in the record. They contend that summary judgment is inappropriate simply because their position is supported by expert testimony. Br. 68. But "an expert's report is not a talisman against summary judgment." *Raskin* v. *Wyatt Co.*, 125 F.3d 55, 66 (2d Cir. 1997). In point of fact, numerous courts have granted summary judgment for auditors even where plaintiffs have cited expert testimony to the effect that the auditors violated GAAP. See, *e.g.*, *Worlds of Wonder*, 35 F.3d at 1425-27 (affirming grant of summary judgment because plaintiff had failed to establish scienter where plaintiffs submitted expert declaration that company's financial statements violated GAAP); *In re Software Toolworks, Inc.*, 50 F.3d 615, 624 (9th Cir. 1994) (same). Even the one case cited by plaintiffs, *In re Apple Computer Sec. Litig.*, 886 F.2d 1109 (9th Cir. 1989), confirms that "where the evidence is [] clear * * *, the court is not required to defer to the contrary opinion of plaintiffs' 'expert.'" *Id.* at 1116.

The opinions of plaintiffs' accounting experts, Harris Devor and Douglas Carmichael, are simply too conclusory and run too far afield of the record to defeat summary judgment. Perhaps the most unfounded conclusion reached by these experts is that IKON policy is the equivalent of GAAP. Br. 21-22 n.8. As we state in our opening memorandum (at 36-37), IKON policy is *not* the equivalent of GAAP, and witness after witness has so testified. Nonetheless, plaintiffs and their experts insist on ignoring the record and, instead, assert a "belief" that is contradicted by the evidence. See, *e.g.*, Br. 31. But "[a]n expert's opinion that lacks any credible support does not create an issue of fact." *American Key Corp.* v. *Cole Nat'l Corp.*, 762 F.2d 1569, 1580 (11th Cir. 1985).

It is no surprise that plaintiffs' experts cling to the fallacy that IKON policy and GAAP are one and the same, for many of the "expert" findings are based entirely on this supposition. Absent this fundamental, but unsupportable (at least by record evidence) premise, plaintiffs' experts could not reach the conclusion that IKON's accounts receivable reserve was overstated, a conclusion to which plaintiffs devote a substantial portion of their opposition. Br. 9-12, 22-26, 31-33.

Nor is the unwarranted conflation of IKON policy with GAAP the only respect in which plaintiffs' experts opinions are belied by the record. For example, Devor and Carmichael opine that there are no workpapers showing work done to evaluate the accounts receivable reserve on a consolidated basis (Br. 11-12), and that E&Y did not evaluate IKON's lease default reserve on a consolidated basis (*id.* at 17-18). Both assertions are utterly without merit. See Section II.C, *supra*.

One crucial point must be added. We do not simply *dispute* plaintiffs' experts when they opine, conclusorily, that E&Y was "reckless." We say that there is no *evidence* on the record to support that opinion. Simply slapping a Ph.D.'s (or CPA's) imprimatur on otherwise insufficient evidence does not justify hauling conscientious professionals before a jury in billion dollar lawsuits. The summary judgment rule was designed to screen out just such cases.

F. "Please Ignore The Arthur Andersen Evidence"

Not surprisingly, plaintiffs have shied away from the most telling evidence of all — that relating to Arthur Andersen's involvement in and conclusions regarding the Special Procedures. Indeed, in a case where plaintiffs must show that "no reasonable accountant would have made the same decision if confronted with the same facts," the evidence relating to Arthur Andersen is absolutely devastating to plaintiffs' case. Plaintiffs have made no secret of this fact — first filing a motion *in limine* to preclude reference to Arthur Andersen's work, and then arguing, quite

implausibly, that the Andersen evidence does not negate an inference that E&Y acted recklessly. Br. 45-48. The undisputed evidence, however, disproves plaintiffs' argument.

There is *no* dispute that Andersen was hired to be the "eyes and ears" of the Board of Directors during the Special Procedures. There is *no* dispute that Andersen had access to all of E&Y's 1997 workpapers and that Andersen conducted a thorough review of those workpapers. There is *no* dispute that Andersen understood that it had a duty to notify the Board if it disagreed with the conclusions reached during the Special Procedures. There is *no* dispute that Andersen did not disagree with the allocation of adjustments identified during the Special Procedures. Finally, there is *no* dispute that Andersen did *not* disagree with the decision not to restate IKON's 1997 financial statements. See E&Y Mem. at 31-33.

In the face of such compelling evidence, plaintiffs understandably seek to minimize the role that Andersen played in this case. They complain that Andersen did not opine on the "ultimate issues" in this case — whether IKON's financial statements complied with GAAP, and whether E&Y's audit complied with GAAS. Even if true, that makes not the slightest difference. The fact is, the two Andersen auditors who testified in this case stated that they had discerned no "significant deficiency" in E&Y's audit. McAleer Tr. 142; Costello Tr. 205. As for plaintiffs' contention that Andersen found some of the same problems in E&Y's audit that plaintiffs describe, we certainly disagree with that characterization of Andersen's findings; but even if that were true, it is beside the point: The standard is not whether a reasonable accountant would have performed the *same audit* as E&Y — it is whether a reasonable accountant would have reached the same *decision*. And it simply cannot be disputed here that Andersen, when confronted with the same "facts" — the 1997 workpapers and the workpapers for the Special Procedures — made the same "decision" — that the 1997 financial statements were not materially in error so as to require misstatement.

* * * * *

To circle back to where we began: plaintiffs' burden in establishing scienter is extremely high. They must show that E&Y's audit procedures — which the undisputed evidence shows entailed months of planning and more than 10,000 hours of work — were "so shoddy" as to amount to nothing more than a "pretended audit." And they must show that no reasonable accountant would "reach the same decision" if "confronted with the same facts" — in a case in which the undisputed evidence shows that, after a thorough review of E&Y's 1997 workpapers and the work done during the Special Procedures, Arthur Andersen agreed that IKON's 1997 financial statements did not need to be restated. Plaintiffs parry this onslaught in the usual fashion: with regard to the law, they ignore it, and with regard to the evidence, they misstate it. Their effort is simply insufficient to withstand summary judgment.

III. PLAINTIFFS CANNOT PREDICATE LIABILITY ON IKON'S OCTOBER 15, 1997 PRESS RELEASE

In our opening memorandum (at 48-53), we showed that under *Central Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*, *supra* — in which the Supreme Court rejected aiding-and-abetting as a predicate for liability in private 10b-5 actions — E&Y may not be held responsible for any alleged misstatement contained in IKON's October 15, 1997 earnings release. Plaintiffs contend, however, that because E&Y "consulted" on the release (Br. 65), "reviewed" and gave "comments" on it (*id*. at 65-66), "approved" it before it went out (*id*. at. 67), and "had reason to know that [IKON] would use its financial statements * * * in a public medium" (*id*. at 65), E&Y

may therefore be held liable as a "primary violator," notwithstanding *Central Bank*.[6] That is simply not the law.

Wright v. *Ernst & Young LLP*, 152 F.3d 169 (2d Cir. 1998), *cert. denied*, 525 U.S. 1104 (1999) — whose analysis has been applied by the only two cases in this Circuit to have decided the issue (see *Copland* v. *Grumet*, 88 F. Supp. 2d 326, 332 (D.N.J. 1999); *Vosgerichian* v. *Commodore, Int'l*, 862 F. Supp. 1371, 1378 (E.D. Pa. 1994)) — is directly on point. There, the Second Circuit held that a defendant may not be held liable under Section 10(b) for a particular misstatement unless the statement at issue was "attributed to that specific actor at the time of public dissemination." 152 F.3d at 175. "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)." *Ibid.*, *quoting* *Shapiro* v. *Cantor*, 123 F.3d 717, 720 (2d Cir. 1997). That principle is completely dispositive in this case: the October 15 press release did not mention E&Y, much less "attribute" any statement to E&Y. Accordingly, the press release simply was not the "statement" of E&Y for liability purposes.

Plaintiffs attempt to distinguish *Wright*, and, failing that, they urge this Court to reject it. Both efforts are unavailing. Just as in the present case, the plaintiffs in *Wright* alleged that the auditors had approved the press release before it was disseminated. See 152 F.3d at 172. But that did not dissuade the court from concluding that the auditor had engaged in nothing more than aiding-and-abetting activity, which under *Central Bank* is not actionable. Nor should *Wright* be

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[6] Plaintiffs also state, in passing (Br. 69), that E&Y "played an essential role in the decision to issue" the October 15 press release. Perhaps that is just their way of summarizing the other steps taken by E&Y; but if it is meant to suggest that E&Y did anything beyond reviewing, commenting on, and ultimately agreeing with the text of, the October 15 release, the statement is false. Not surprisingly, plaintiffs provide no record citation for this assertion; the evidence in fact shows that this was IKON's press release, first and last, and that the statements made in the release were made by IKON and on behalf of IKON (see Guinan Tr. 205 (Ex. 78)).

disregarded as bad law. Indeed, although plaintiffs note (Br. 68) that the Third Circuit has "not adopted" the *Wright* standard, they fail to mention that both courts in this Circuit to have decided this issue after *Central Bank* have used the same analysis as the *Wright* court. See *Copland*, 88 F. Supp. 2d at 332 (adopting *Wright* and dismissing claim against auditor because "participation in [the fraud] cannot be considered the equivalent of making the false statements themselves"); *Vosgerichian*, 862 F. Supp. at 1378 (dismissing claim against auditing firm where plaintiff alleged only that the auditor had rendered "guidance and express approval" to, "advised and concurred with," and "provided direct and substantial assistance to" the corporate defendant's fraud).[7]

The *Wright* standard is quite plainly correct. Were the law otherwise, aiding-and-abetting liability would effectively be revived, albeit in a different guise. After all, most if not all public companies ask their auditors to "review" earnings releases, "comment on" them, and provide their "approval" before they issue the releases to the public. If an auditor's performing those routine functions were enough to convert the press release into the auditor's "statement," *Central Bank* would have no meaning at all. That is the crucial point recognized by the Second Circuit and by the only two courts in this Circuit to have decided the issue. There is no reason for this Court to break ranks.

Nor is there any reason for this Court to cast its lot with the handful of cases that have suggested that Section 10(b) liability may be extended to persons that have "significant" or "substantial" participation in making the misstatement. As the Second Circuit has noted, "[a]llegations of 'assisting,' '*participating in*,' 'complicity in' and similar synonyms * * * all fall within the prohibitive bar of *Central Bank*." *Shapiro*, 123 F.3d at 720 (emphasis added). For that

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[7] Plaintiffs' failure to address these crucial decisions is all the more telling since we expressly drew their attention to the cases in our opening memorandum (at 50-51).

reason, the "substantial participation" standard has been soundly rejected by just about every court to consider it. See, *e.g.*, *Anixter* v. *Home-Stake Production Co.*, 77 F.3d 1215, 1226 (10th Cir. 1996) (declining to adopt substantial participation test; stating, "[r]eading the language of § 10(b) and 10b-5 through the lens of *Central Bank of Denver*, we conclude that in order for defendants to 'use or employ' a 'deception' actionable under the antifraud law, they must themselves make a false or misleading statement * * *."); *Wright*, 152 F.3d at 176 (same).

In any event, as discussed in our opening memorandum (at 53 n.27) — and nowhere addressed by plaintiffs — E&Y's role with regard to IKON's press release does not constitute "substantial participation" within the meaning of the cases that have articulated that test. For example, in *In re Software Toolworks, Inc.*, 50 F.3d 615, 628-29 (9th Cir. 1994), the accounting firm was mentioned by name in a letter to the SEC containing the alleged misrepresentations. Here, on the other hand, E&Y was not mentioned in IKON's press release. And in *Cashman* v. *Coopers & Lybrand*, 877 F. Supp. 425, 433 (N.D. Ill. 1995), the plaintiffs alleged that the auditors had "masterminded" the public statements. Here, there is no such allegation. Finally, although plaintiffs cite *In re Kidder Peabody Sec. Litig.*, No. 94-CIV.-3954, 1995 WL 590624 (S.D.N.Y. Oct. 4, 1995), for the proposition that "supplying information can lead to primary liability under Rule 10b-5" (Br. 69), there is no allegation in the present case that E&Y "supplied" any of the information contained in IKON's press release.[8]

Accordingly, because there is no evidence supporting a finding that E&Y made any statement with regard to IKON's October 15 press release, the Court should enter summary

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[8] Moreover, to the extent the 1995 decision of the Southern District of New York in *Kidder Peabody* permits a finding of liability where no statements are attributed to a defendant, it does not survive the more recent Second Circuit decision in *Wright*.

judgment with respect to all claims based upon the acquisition of IKON stock prior to December 24, 1997, the date on which E&Y's audit report was first issued.

CONCLUSION

For the foregoing reasons, the Court should enter summary judgment in favor of E&Y on plaintiffs' claims. In the alternative, the Court should enter summary judgment with respect to all claims arising prior to December 24, 1997.

Respectfully submitted,

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