

2nd Circ. Says Omnicare Kills Puda Investors' Auditor Claims

By **Jody Godoy**

Law360, New York (May 20, 2016, 8:31 PM ET) -- The Second Circuit affirmed a win for Moore Stephens Hong Kong on Friday in an investor suit claiming the accounting firm negligently overlooked fraud by a Puda Coal executive, saying the Supreme Court's recent Omnicare decision undermines the investors' Securities Act claims.

The three-judge panel upheld a ruling dismissing shareholders' claims under Section 11 of the Securities Act of 1933 — which creates civil liability for false information in securities registration statements — because the Supreme Court's ruling last year in *Omnicare Inc. et al. v. Laborers District* raised the bar, the court said.

Omnicare held that statements of opinion, rather than statements of fact, generally don't create liability under federal securities laws. Because the audit reports for Puda's 2009 or 2010 financial statements were opinions, and investors had no evidence that the auditor either withheld facts behind its reports or did not believe its own opinions, their claims fail, the panel said.

"Audit reports, labeled 'opinions' and involving considerable subjective judgment, are statements of opinion subject to the Omnicare standard for Section 11 claims," the panel said.

Investors, who have also pursued Puda underwriters and, along with the U.S. Securities and Exchange Commission, its two principals, had pressed for a reversal of U.S. District Judge Katherine B. Forrest's June 2014 decision letting the auditor off the hook.

Puda was hit with a slew of shareholder class actions in 2011, after it was reported that Chairman Ming Zhao and his brother Yao Zhao plundered the company by selling off its operating unit to a Chinese private equity firm beginning in 2009.

Investors said the sale had been hidden from them ahead of a 2010 U.S. stock sale. Moore Stephens audited Puda in 2009 and 2010.

On Friday, the Second Circuit upheld dismissal of the Securities Act claims along with claims under the Securities Exchange Act of 1934. The purported red flags investors claim the auditor should have seen before issuing a "clean audit" for Puda's 2009 and 2010 financial statements were not enough to trigger liability under the Exchange Act, the panel said.

Federal judges in New York had been reluctant to dismiss cases against auditors under Section 11. Ernst

& Young LLP fought allegations by Overseas Shipholding Group Inc. investors for years before finally getting them thrown out in June on summary judgment.

In February, U.S. District Judge Jed S. Rakoff certified a class of investors suing Brazilian oil giant Petrobras along with its auditor, PricewaterhouseCoopers, over a stock drop caused by the now-infamous bribery scandal.

Though unpublished, the Second Circuit's decision on Friday could affect how courts rule on auditor liability in Section 11 cases going forward.

Brian Massengill, who represents Moore Stephens, said the decision is significant in that it lets judges know that the standard Omnicare standard applies in Section 11 claims against auditors.

"This decision clarifies that the audit opinion is treated as an opinion and analyzed that way under Omnicare," Massengill said.

Circuit Judges Dennis Jacobs, Barrington D. Parker and Reena Raggi decided the appeal.

The plaintiffs are represented by Laurence M. Rosen of the Rosen Law Firm PA.

The auditor is represented by Brian J. Massengill, James Schroeder, Justin McCarty, Alexandra Newman and Abby Bartine of Mayer Brown LLP.

The appeal is In re: Puda Coal Securities, case number 15-2100, in the U.S. Court of Appeals for the Second Circuit.

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