UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE PENN WEST PETROLEUM LTD. SECURITIES REGULATION

No. 14 Civ. 06046 (JGK)(GWG)

ECF CASE

MEMORANDUM OF LAW IN SUPPORT OF MOTION TO DISMISS OF DEFENDANT MURRAY NUNNS

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Defendant Murray Nunns respectfully moves to dismiss all claims asserted against him in Plaintiffs' Consolidated Amended Class Action Complaint ("CAC") for the reasons set forth below and in the brief filed by Penn West and defendants Curran, Roberts, and Takeyasu ("Company Brief" or "Company Br."), which Mr. Nunns incorporates herein by reference.

PRELIMINARY STATEMENT

Murray Nunns is a geologist who served as the Chief Executive Officer of Defendant Penn West Petroleum Ltd. ("Penn West" or the "Company"), a Canadian oil and gas exploration and production company, from the third quarter of 2011 to the second quarter of 2013, after working in other capacities at the Company. In July 2014, more than a year after Mr. Nunns left Penn West, the Company announced that it expected to restate its financials for several prior years, principally to reclassify certain capital expenditures and royalties as operating expenses. The announcement asserted that unspecified "senior finance and accounting personnel" were responsible for the adoption and use of the accounting practices necessitating the restatement. Nowhere, however, did the Company implicate Mr. Nunns, who was never a "finance" or "accounting" employee. Plaintiffs nevertheless seek to hold Mr. Nunns liable for securities fraud based on his purported failure to disclose the alleged accounting violations.

Plaintiffs' allegations fail, because the CAC is devoid of any facts demonstrating that Mr. Nunns was aware of or complicit in any of the alleged accounting improprieties. Plaintiffs' core scienter allegation—the conclusory assertion that "senior accounting management" implemented the challenged accounting practices and overrode internal controls in order to do so (CAC ¶¶ 116-18, 122)—fails for reasons explained in detail in the Company's motion to dismiss. *See* Company Br. Part I.B.1. With respect to Mr. Nunns, the allegation also is completely irrelevant because Plaintiffs do not and cannot allege that he was a member of the accounting department.

In the absence of any factual allegations establishing that Mr. Nunns was aware of or involved in the accounting practices at issue, Plaintiffs rely on allegations that Mr. Nunns should have been aware of the alleged fraud because of his position; because of the magnitude of the restatement; or because he certified financial statements that later allegedly proved incorrect. All of these allegations are insufficient to raise the requisite "strong inference" of scienter under settled law.

Plaintiffs' effort to allege an actionable misstatement or omission against Mr. Nunns also fails. While Plaintiffs recite a laundry list of alleged misstatements and omissions which they attribute to Mr. Nunns, they fail adequately to allege how these statements were false or misleading at the time they were made. For example, Plaintiffs assert that Mr. Nunns falsely certified the accuracy of the Company's financial statements, but each certification attested only to Mr. Nunn's subjective belief in the accuracy of the financial statements, based on "his knowledge." Because Plaintiffs fail to allege any facts demonstrating that Mr. Nunns did not believe in the accuracy of the Company's financial statements at the time of these certifications, the CAC fails to establish that the certifications are actionable false statements.

Plaintiffs also claim that Mr. Nunns made misleading omissions by failing to disclose the Company's alleged accounting improprieties during investor conference calls, and by failing to correct statements made by others, but these allegations fail for a variety of reasons, including that omissions are not actionable absent a duty to disclose. Contrary to Plaintiffs' allegations, Mr. Nunns did not have a duty to disclose arcane accounting practices of the Company—practices that Plaintiffs have failed to demonstrate he was even aware of—every time he discussed the Company's operating costs on an investor conference call. Moreover, there is no general duty to rectify misstatements of others under Section 10(b). Rather, a defendant may only be held liable if the defendant personally made the false statement at issue.

BACKGROUND

Mr. Nunns, a geologist with a long career in the oil and gas industry, first joined Penn West as an outside director in 2005. (CAC ¶ 23.) Three years later, he became an officer of the Company, serving as President from February 2008 through June 2013, as Chief Operating Officer from February 2008 through August 2011, and as Chief Executive Officer from August 2011 through June 2013. (*Id.*) Mr. Nunns left Penn West in June 2013, more than a year before the Company announced, in July 2014, that it would issue a restatement. (*Id.* ¶ 24.) Mr. Nunns' tenure as an officer thus began after the inception of the alleged "accounting scheme" in 2007 and ended over a year before the restatement giving rise to this lawsuit. (*See id.* ¶¶ 5, 23.)

Alleged Misrepresentations and Omissions

As an officer at Penn West from 2008 through mid-2013, Mr. Nunns participated in investor conference calls on behalf of the Company. During the calls, Mr. Nunns discussed Penn West's financial results. (*E.g.*, *id.* ¶ 63 (stating that Penn West's 2009 results had "exceed[ed] expectations"); *id.* ¶ 208 (stating that Penn West's "funds flow" was "ahead of the internal expectations, primarily due to higher than budgeted light oil price realizations").) He also addressed Penn West's efforts to control its costs, focusing on increased capital and operational efficiencies. (*E.g.*, *id.* ¶ 63 (stating that Penn West "believe[d]" it could "see an efficiency gain of between 30% to 40% in terms of cost reduction" as it drilled additional wells); *id.* ¶ 178 (stating that Penn West was "committed to optimizing capital and operational efficiencies"); *id.* ¶ 195 (identifying "[c]apital efficiency and production performance" as Penn West's "highest priorities for 2013").) And he discussed Penn West's capital budget (*id.* ¶ 164 (denying need to engage in asset sales to meet capital expenditure guidance); *id.* ¶ 197 (explaining that Penn West had "always . . . plan[ned]" to increase its capital budget at the end of 2012)), as well as sources

of cost pressure on the Company (*id.* ¶ 162 (stating that higher electrical costs, unexpected maintenance, and an expanded automation program resulted in "ops costs a little persistently higher than" the company would like)). A number of other Penn West officers touched on similar subjects during the conference calls. (*E.g.*, *id.* ¶¶ 145, 147, 160, 171, 181, 212.)

Plaintiffs nowhere allege that Mr. Nunns addressed the Company's accounting practices, much less the specific practices at issue in the restatement, in the course of any of the conference calls. Nor does the CAC allege any facts demonstrating that Mr. Nunns was personally involved in any of the challenged practices or even aware of them. Plaintiffs nonetheless assert that it was misleading for Mr. Nunns to fail to disclose these so-called "accounting improprieties" when he discussed the Company's financial results, cost control efforts, and capital budget during the calls. (*Id.* ¶¶ 135-36, 143-44, 162-65, 178-79, 195-98, 208-11, 312.) Plaintiffs further assert that Mr. Nunns misled investors by failing to correct similar purported non-disclosures by other executives who spoke on the calls. (*Id.* ¶¶ 145-48, 160-61, 171-72, 181-82, 212-13, 312.)

As CEO, Mr. Nunns signed a number of the Company's filings with the Securities and Exchange Commission ("SEC"). (*Id.* ¶ 23.) In those filings, Mr. Nunns certified the accuracy of Penn West's financial results and the sufficiency of its internal reporting controls. However, each of the certifications was qualified. As to the Company's financial statements, Mr. Nunns certified only that the statements were accurate "based on my knowledge" or "to the best of my knowledge" at the time. *See* Ex. 1 (6-K for second quarter 2011); Ex. 2 (6-K for third quarter 2011); Ex. 3 (40-F for the year 2011); Ex. 5 (6-K for first quarter 2012); Ex. 6 (6-K for second quarter 2012); Ex. 7 (6-K for third quarter 2012); Ex. 8 (40-F for the year 2012); Ex. 10 (6-K for

first quarter 2013).[1] As to reporting controls, Mr. Nunns' annual certifications attested only to his own subjective "conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report," including his belief that the Company's controls were designed to provide "reasonable assurance" that the Company's financial statements would be reliable. *See* Exs. 3, 8.

Plaintiffs assert that Mr. Nunns' certifications were false, because they failed to disclose the alleged accounting irregularities and internal control problems at the Company (CAC ¶¶ 157, 166, 173, 180, 199, 214, 312), but the CAC fails to plead any facts demonstrating that Mr. Nunns was aware of any of these issues at the time of the certifications. Notably, Mr. Nunns was not the only party to certify the Company's filings. KPMG, the Company's outside auditor, certified that the filings represented Penn West's financial position "fairly, in all material respects" and that Penn West "maintained, in all material respects, effective internal control over financial reporting." *See* Ex. 4 (KPMG certifications for 2011); Ex. 9 (KPMG certifications for 2012). The CAC does not explain why Mr. Nunns, who is not an accountant, should have discovered any of the challenged practices when the Company's expert outside auditor did not.

Penn West's Restatement of Earnings

On July 29, 2014, more than one year after Mr. Nunns left Penn West, the Company announced its intention to restate its financial statements for the years 2012 and 2013, and the

[1] Exhibits are attached to the Declaration of Mark P. Gimbel. On a motion to dismiss pursuant to Fed. R. Civ. P. 12(b)(6), a court may consider "the complaint, documents attached to the complaint as exhibits, and documents incorporated by reference in the complaint." *DiFolco v. MSNBC Cable, LLC*, 622 F.3d 104, 111 (2d Cir. 2010) (internal quotation marks omitted).

first quarter of 2014. (CAC ¶ 10.) In the announcement, the Company asserted that unspecified "senior finance and accounting personnel [were] responsible for the adoption and use" of the accounting practices that prompted the restatement. (*Id.* ¶ 11.)

The practices in question consisted principally of the alleged misclassification of operating expenses as capital expenses (*id.*), an accounting determination that requires "the application of professional judgment" based on the "specific circumstances" at issue.[2] The Company also allegedly misclassified certain operating expenses as royalties. (*Id.* ¶ 284.) Nowhere in the announcement did the Company claim that Mr. Nunns—or indeed anyone outside the finance and accounting departments—was involved in any of the accounting judgments that gave rise to the restatement. Nowhere in the CAC do Plaintiffs allege that Mr. Nunns was involved with or had knowledge of any challenged accounting decision.

The restatement was released on September 18, 2014. (*Id.*) The corrections to the financial statements were relatively modest in relation to the amounts at issue.[3] *See* Ex. 11 (Sept. 18, 2014 press release). For example, although the restatement asserted that Penn West had erroneously classified $146 million of operating expenses as capital expenditures from 2012 through the first quarter of 2014, the Company expended over $2 billion on operating costs during that time period. *See id.* at 2; Ex. 12 at 3 (2013 restatement); Ex 13 at 2 (2014

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[2] *See* Company Br. Background Part B; *see also* Decl. of Robert J. Giuffra, Jr., dated Mar. 6, 2015, Ex. 4 (Canadian Generally Accepted Accounting Principles ("GAAP") § 1000.43); *id.* Ex. 3 (International Accounting Standard 16.9 (noting that "judgement [*sic*] is required" in applying capital expense recognition criteria "to an entity's specific circumstances")).

[3] Dollar amounts are stated in Canadian Dollars, as reported by the Company in its SEC filings.

restatement). Likewise, while the restatement asserted that the Company had improperly classified $221 million of operating expenses as royalties during the same period, the Company paid over $1 billion in royalties during that time. *See* Ex. 11 at 2; Ex. 12 at 3; Ex 13 at 2.

The impact of the restatement on financial metrics that Plaintiffs allege were of particular importance to investors was minor. For example, Plaintiffs describe the "netback"—revenues realized per barrel of oil minus certain costs associated with bringing oil to market—as a "key financial metric" of Penn West. (CAC ¶ 36.) The restatement resulted in only modest reductions in netbacks: 7% in 2009, 4% in 2012, 5% in 2013, and 3% in 2014 (Q1). (*Id.* ¶¶ 134, 188, 248, 262.) Similarly, Plaintiffs assert that "funds flow"—cash flow generated from operating activities net of expenses—is another key metric. (*Id.* ¶ 34.) The restatement resulted in only modest reductions in funds flow: 8% in 2009, 5% in 2012, 7% in 2013, and 4% in 2014 (Q1). (*Id.* ¶¶ 134, 188, 248, 262.) [4] In certain years, the restatement even had the positive effect of increasing net income, with increases of $3 million in 2011, $29 million in 2013, and $7 million in the first quarter of 2014. Ex. 11 at 4; Ex. 12 at Annual Consol. Fin. Stmts. (Restated) 14.

Following the restatement, Plaintiffs filed this suit against the Company and several of its current and former officers and directors, including Mr. Nunns.

ARGUMENT

I. PLAINTIFFS' SECTION 10(B) CLAIM MUST BE DISMISSED.

To state a claim under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule10b-5 promulgated thereunder, 17 CFR § 240.10b-5, a plaintiff must allege

[4] The Complaint does not plead the impact of the restatement on netbacks or funds flow in 2010 or 2011, but Plaintiffs concede that netbacks were never overstated by more than 8 percent and that funds flow was never overstated by more than 12 percent. (CAC ¶ 7.)

that the defendant "(1) made misstatements or omissions of material fact, (2) with scienter, (3) in connection with the purchase or sale of securities, (4) upon which the plaintiff relied, and (5) that the plaintiff's reliance was the proximate cause of its injury." *ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 105 (2d Cir. 2007). Plaintiffs' Section 10(b) claim against Mr. Nunns must be dismissed for failure to plead several of these essential elements.

A. Plaintiffs Fail to Allege a Strong Inference of Scienter as to Mr. Nunns.

In an effort to curb abusive litigation, Congress enacted the Private Securities Litigation Reform Act ("PSLRA"), 15 U.S.C. § 78u-4, which imposes a heightened pleading standard on plaintiffs in securities fraud cases. Under the PSLRA, a plaintiff alleging securities fraud must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind," *id.* § 78u-4(b)(2)(A)—i.e., scienter, which is defined as "an intent to deceive, manipulate or defraud," *Kalnit v. Eichler*, 264 F.3d 131, 138 (2d Cir. 2001). A securities fraud complaint must be dismissed unless "the inference of scienter" established in the complaint is "cogent and at least as compelling as any opposing [nonculpable] inference one could draw from the facts alleged." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 324 (2007).

A plaintiff may plead scienter by alleging "facts (1) showing that the defendant[] had both motive and opportunity to commit the fraud or (2) constituting strong circumstantial evidence of conscious misbehavior or recklessness." *ATSI*, 493 F.3d at 99. Here, as explained in in the Company Brief, Plaintiffs do not plead that any of the individual defendants had a motive to commit fraud beyond the generalized motives possessed by all executives, which are legally insufficient to establish scienter. *See* Company Br. Part I.A. Because Plaintiffs do not plead a motive sufficient to establish scienter, they must instead plead strong circumstantial evidence of conscious misbehavior or recklessness, and the strength of their allegations "must be correspondingly greater." *ECA v. JP Morgan Chase Co.*, 553 F.3d 187, 199 (2d Cir. 2009).

At a minimum, Plaintiffs must allege "conduct which is highly unreasonable and which represents an extreme departure from the standards of ordinary care to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it." *Kalnit*, 264 F.3d at 142. In other words, the well-pleaded factual allegations of the complaint must, at the least, demonstrate "conscious recklessness—i.e., a state of mind approximating actual intent, and not merely a heightened form of negligence." *Novak v. Kasaks*, 216 F.3d 300, 312 (2d Cir. 2000) (internal quotation marks omitted). The CAC utterly fails to meet this requirement with respect to Mr. Nunns.

Plaintiffs' core scienter allegation—that the Company supposedly admitted that unspecified "senior finance and accounting personnel" were responsible for adopting improper accounting practices and overriding the Company's internal controls (*e.g.*, CAC ¶¶ 122-123)—is deficient, for reasons explained at length in the Company's motion to dismiss. *See* Company Br. Part I.B.1. The allegation is also completely irrelevant to Mr. Nunns—a geologist who served as the Chief Operating Officer and Chief Executive Officer of Penn West and was never a "finance" or "accounting" employee. There are no allegations in the CAC demonstrating that Mr. Nunns played any role in the Company's accounting, much less that he had knowledge of or was complicit in any of the accounting practices or internal control deficiencies at issue.

Plaintiffs also rely on a variety of other allegations to demonstrate scienter, but none suffices. For example, it is well established that the existence of accounting violations alone cannot support an inference of scienter. *See, e.g.*, *Novak*, 216 F.3d at 309 ("[A]llegations of GAAP violations or accounting irregularities, standing alone, are insufficient to state a securities fraud claim."); *In re BISYS Sec. Litig.*, 397 F. Supp. 2d 430, 448 (S.D.N.Y. 2005) (rejecting plaintiffs' "circular" argument that GAAP violations, "without allegations of knowledge or

recklessness, indicate that the . . . [d]efendants acted with *scienter*"). This is because accounting decisions are often matters of *judgment*, as to which reasonable minds may disagree. *See In re Wachovia Equity Sec. Litig.*, 753 F. Supp. 2d 326, 365 (S.D.N.Y. 2011) (acknowledging that accounting principles are "far from being a canonical set of rules," and instead "tolerate a range of reasonable treatments" (internal quotation marks omitted)). To plead scienter based on an accounting violation, Plaintiffs must "plead that [the defendant] had access to particular, identified internal reports that would have alerted [him] to a deliberate (and hence fraudulent) misapplication of [an accounting] rule." *City of Brockton Ret. Sys. v. Shaw Group Inc.*, 540 F. Supp. 2d 464, 473 (S.D.N.Y. 2008). Such allegations are entirely absent with respect to Mr. Nunns.

Likewise, "it is well settled that mere fact of a restatement of earnings does not support a strong, or even a weak, inference of scienter." *Id.* at 472; *see In re Turquoise Hill Res. Ltd. Sec. Litig.*, No. 13 Civ. 8846 (LGS), 2014 WL 7176187, *7 (S.D.N.Y. Dec. 16, 2014) (holding that a restatement does not "suggest knowledge or intent to misstate when the financial results were originally published, particularly when the error was a matter of judgment"). Instead, a plaintiff must prove that the defendants "were furnished with information that would have allowed them to discern that the financial data was wrong." *Shaw,* 540 F. Supp. 2d at 473. Nothing like that is pleaded in the CAC: there is not a single factual allegation demonstrating that Mr. Nunns was aware that any financial statement of the Company was inaccurate at the time it was issued—a patent defect. *See Novak*, 216 F.3d at 309 ("Where plaintiffs contend defendants had access to contrary facts, they must specifically identify the reports or statements containing this information.").

Nor can Plaintiffs manufacture an inference of scienter from the fact that Mr. Nunns was an executive at the Company. Courts routinely reject efforts to infer knowledge of accounting improprieties or other adverse information based solely on a defendant's status as an officer. *See, e.g.*, *In re AOL Time Warner, Inc. Sec. & "ERISA" Litig.,* 381 F. Supp. 2d 192, 224-25 (S.D.N.Y. 2004) (allegations that Time Warner CEO should have known of accounting improprieties based on his status held insufficient to establish scienter); *In re Health Mgmt. Sys., Inc. Sec. Litig.*, No. 97 Civ. 1865 (HB), 1998 WL 283286, at *6 (S.D.N.Y. June 1, 1998) ("[C]ourts have routinely rejected the attempt to plead scienter based on allegations that because of defendants' board membership and/or their executive managerial positions, they had access to information concerning the company's adverse financial outlook."). Knowledge of accounting irregularities will not be "imputed to [a] company's officers and directors . . . , in the absence of allegations of fact from which one could infer that the alleged accounting improprieties are either being committed by the officer or were reported to him." *Shaw*, 540 F. Supp. 2d at 473; *In re Bristol-Myers Squibb Sec. Litig.*, 312 F. Supp. 2d 549, 568 (S.D.N.Y. 2004) ("[P]laintiffs must allege facts from which a strong inference can be drawn that Defendants knew or were reckless in not knowing that the accounting [method] at issue was wrong."). Such allegations are utterly lacking here: Plaintiffs nowhere allege that Mr. Nunns participated in the accounting practices at issue or that such practices were reported to him.

The fact that Mr. Nunns signed regulatory filings and certifications of the Company is likewise insufficient. A defendant's certification of financial statements or internal controls does not demonstrate scienter in the absence of evidence—and none is pleaded here—that the certification was "not honestly and reasonably believed to be true when made." *In re Bausch & Lomb, Inc. Sec. Litig.*, 592 F. Supp. 2d 323, 341 (W.D.N.Y. 2008) (deeming CEO certification of

regulatory filings insufficient to support an inference of scienter); *see, e.g., Goplen v. 51job, Inc.*, 453 F. Supp. 2d 759, 775 (S.D.N.Y. 2006) (holding that defendant's signature on an "SEC filing—without specific allegations of reasonably available facts that should have put him on notice that the reported financial results were false—does not give rise to a strong inference of scienter"). Here, moreover, the fact that Penn West's independent auditor also signed off on the Company's financial statements and the adequacy of its internal controls negates any inference of scienter. *See, e.g.*, *In re Bausch & Lomb, Inc. Sec. Litig.*, 592 F. Supp. 2d at 341 (holding that nonculpable inference was accentuated by report of independent auditor "which had conducted its own review [of the company's internal controls] . . . [and] concluded that management's assessment was fair and that [the company's] internal controls were effective").

The alleged magnitude of the accounting restatement also is insufficient, because "it is well established that the size of the fraud alone does not create an inference of scienter." *E.g.*, *Glaser v. The9, Ltd.*, 772 F. Supp. 2d 573, 586 (S.D.N.Y. 2011) (finding seventy-two percent write-down insufficient to plead scienter absent allegation that defendants knew write-down would be necessary); *In re BISYS Sec. Litig.*, 397 F. Supp. 2d at 448 (rejecting scienter argument based on approximate twenty percent overstatement of revenues and observing that, "[i]n those cases in which courts in this circuit found that the size of the fraud contributed to an inference of scienter, the fraud itself was significantly larger"). Moreover, Plaintiffs' allegations about the magnitude of the alleged "fraud" are overblown. (*See* CAC ¶ 126.) As discussed above, the restated expenses were relatively modest compared to Penn West's overall capital and operating budgets, and the restatement had only a minor effect on key financial metrics such as netbacks and funds flow. The restatement even increased net income in certain years. The relatively modest, and sometimes positive, effects of the restatement undercut Plaintiffs' allegations of

fraudulent intent. *See, e.g.*, *In re Magnum Hunter Res. Corp. Sec. Litig.*, 26 F. Supp. 3d 278, 295 (S.D.N.Y. 2014) (noting that the "'modest size'" of a restatement "undercuts an inference of fraud" (quoting *Plumbers & Pipefitters Local Union No. 719 Pension Trust Fund v. Conseco Inc.*, No. 09 Civ. 6966 (JGK), 2011 WL 1198712, at *22 (S.D.N.Y. Mar. 30, 2011)).

The duration of the alleged accounting irregularities is no more helpful to Plaintiffs. While the challenged practices purportedly spanned seven years, Plaintiffs allege that the practices began in 2007 (CAC ¶ 5)—before Mr. Nunns became an officer (CAC ¶ 23)—and continued for more than a year after his 2013 departure (CAC ¶¶ 10, 23, 24). The fact that the practices were adopted before Mr. Nunns joined management—and continued long after he was gone—undermines any inference that he was responsible for the so-called "accounting scheme" and instead supports a competing, non-culpable inference: that Penn West's accounting department adopted the challenged practices prior to Mr. Nunns' tenure, that the practices continued unbeknownst to Mr. Nunns during his service as COO and CEO, and that they remained undiscovered for more than a year while the Company was under new management because the supposed improprieties were not visible to a CEO.[5] *See Teamsters Local 445*

[5] Plaintiffs assert that the challenged accounting practices were "obvious" because Penn West's current Chief Financial Officer, David Dyck, supposedly discovered them "within weeks" of joining the Company. (CAC ¶ 128.) As explained in detail in the Company Brief, Plaintiffs' allegations about the time it took for Mr. Dyck to discover these accounting issues are demonstrably incorrect. *See* Company Br. Part I.B.2. Further, these allegations shed no light whatsoever on whether such practices would have been visible to a Chief Executive Officer, particularly one without special expertise in accounting, like Mr. Nunns.

Freight Div. Pension Fund v. Dynex Capital Inc., 531 F.3d 190, 197 (2d Cir. 2008) (scienter allegations inadequate where complaint supported plausible inference that misleading financial information had been "fed [to executives] from below"); *In re Longtop Fin. Tech. Ltd. Sec. Litig.,* 910 F. Supp. 2d 561, 572 (S.D.N.Y. 2012) (In determining whether scienter is adequately pleaded, "a court must consider plausible, nonculpable explanations for the defendant's conduct, as well as inferences favoring the plaintiff.") (internal quotation marks omitted)) .

Plaintiffs also cannot conjure a strong inference of scienter from their allegation that Penn West misstated its "most critical financial metrics at a time when these exact metrics were the focus of investor attention and concern." (CAC ¶ 124.) Although Plaintiffs cherry pick a number of statements in an effort to suggest that Penn West's officers paid disproportionate heed to metrics such as netbacks and funds flow, each of those statements was made after Mr. Nunns left the Company. (*See, e.g.*, CAC ¶¶ 38, 124.) Moreover, Plaintiffs' claim that the Company was focused on manipulating netbacks and funds flow rings hollow, in light of the modest impact of the challenged practices on these metrics. More importantly, the mere fact that the restatement affected metrics that were important to the Company or investors is insufficient to raise an inference of scienter "[i]n the absence of any allegations of suspicious circumstances or of knowledge of facts" demonstrating that Nunns was aware of the accounting practices that allegedly distorted these metrics. *See Dobina v. Weatherford Int'l Ltd.*, 909 F. Supp. 2d 228, 252 (S.D.N.Y. 2012) (allegations inadequate to demonstrate scienter, despite "defendants' and investors' considerable focus on [the] tax rates [at issue]," because plaintiffs failed to allege facts supporting defendants' knowledge of the accounting violations or that they were obvious).

Just as Plaintiffs' allegations fail individually to demonstrate scienter, they are insufficient collectively. Absent any factual allegations demonstrating that Mr. Nunns was

aware of any accounting impropriety or deficiency in internal controls, Plaintiffs' parade of insufficient allegations adds up to nothing. Instead of supporting the requisite strong inference of scienter, "zero plus zero plus zero plus zero plus zero" just equals zero. *Shaw*, 540 F. Supp. 2d at 472-75 (dismissing Section 10(b) claims against CEO and CFO for failure to plead scienter, despite allegations that, *inter alia*, the company issued a restatement, its internal controls were deemed deficient, accounting violations occurred, the defendant officers were "'hands on' executives," and the accounting staff had "widespread knowledge of problems," because none of the allegations "admit[ted] of an inference of fraud").

B. Plaintiffs Fail to Allege Any Actionable Misstatements or Omissions Attributable to Mr. Nunns.

The alleged misstatements and omissions that Plaintiffs attribute to Mr. Nunns fall into three broad categories: (1) alleged misrepresentations and omissions in regulatory filings (CAC ¶ 312(a), (c)); (2) alleged misrepresentations and omissions on investor conference calls (*id.* ¶ 312(b)); and (3) alleged failures to correct statements made by other Penn West executives on such calls (*id.* ¶ 312(b)). As explained in detail below, Plaintiffs fail to plead an actionable misrepresentation or omission by Mr. Nunns in any of these categories.

1. The CAC Fails to Plead Any Actionable False Statements of Mr. Nunns in the Company's Regulatory Filings.

The CAC alleges that Mr. Nunns is liable for misrepresentations and omissions in regulatory filings of Penn West. (CAC ¶ 312(a), (c).) The allegation fails because Mr. Nunns' certifications of the Company's filings were limited and qualified, and Plaintiffs do not plead facts demonstrating that they were false at the time they were made.

First, with respect to the Company's financial statements, Mr. Nunns certified only that the statements were accurate "[b]ased on my knowledge" or words to that effect. *See* Exs. 1-3, 5-8, 10. Because these certifications were inherently subjective and qualified by Mr. Nunns'

own personal knowledge, Plaintiffs cannot plead falsity merely by asserting that the financial statements were ultimately restated; instead, they must also plead facts demonstrating that Mr. Nunns was aware that the financial statements were false at the time of his certifications. *See Hall v. The Children's Place Retail Stores, Inc.*, 580 F. Supp. 2d 212, 231-32 (S.D.N.Y. 2008) (holding that, "for [regulatory] certifications to be materially false, it is insufficient for the financial statements themselves to have been false—defendants must also have had knowledge of that falsity"); *In re Magnum Hunter Res. Corp. Sec. Litig.*, 26 F. Supp. 3d at 295 (rejecting falsity of Sarbanes-Oxley certifications in the absence of allegations that the certifications were false "at the time that they were made"). The CAC fails to plead any such facts.

Similarly, with respect to internal controls, Mr. Nunns' certifications presented his own subjective "conclusions about the effectiveness of the disclosure controls and procedures," Exs. 3, 8 (annual certifications), including his opinion that the Company had designed internal controls that were sufficient to provide "reasonable assurance" as to the reliability of the Company's financial statements, Exs. 1-3, 5-8, 10. As such, the certifications were subjective statements of opinion. *See Dobina*, 909 F. Supp. 2d at 245 (acknowledging that similar certifications concerning internal controls "involve a certain amount of subjectivity"). Such subjective statements are "actionable only if the defendant's opinions were both false and not honestly believed when they were made." *Kleinman v. Elan Corp.*, 706 F.3d 145, 153 (2d Cir. 2013); *Fait v. Regions Fin. Corp.*, 655 F.3d 105, 112 (2d Cir. 2011) (holding that a statement of belief or opinion is actionable under the securities laws only if the speaker knows it to be false). Because the CAC fails to plead any facts demonstrating that Mr. Nunns was aware of any internal control deficiency at the time of the certifications—or otherwise did not honestly believe in his certification of the Company's internal controls—the certifications do not constitute

actionable false statements. *See In re Magnum Hunter Res. Corp. Sec. Litig.*, 26 F. Supp. 3d at 294-95 (complaint failed to allege falsity of statements endorsing internal controls in the absence of allegations defendants were aware of internal control deficiencies at time of the statements).

2. Mr. Nunns' Alleged Statements and Omissions on Investor Conference Calls Are Not Actionable.

The CAC alleges that Mr. Nunns made a number of statements on investor conference calls concerning topics such as the company's financial results, cost control efforts, capital expenditures, and budget. (CAC ¶¶ 135, 143, 162, 164, 178, 195, 197, 208, 201, 312(b).) As explained in detail in the Company Brief, many of these statements are non-actionable statements of opinion as to the Company's future performance or ability to control costs. *See* Company Br. Part II. Even putting that defect aside, however, Plaintiffs' theory of why these statements are false and actionable is fundamentally flawed. Plaintiffs allege that the statements were materially misleading, because Nunns failed simultaneously to disclose the Company's allegedly improper accounting practices. (*See, e.g.*, CAC ¶¶ 143-44.) The allegation is untenable because it rests on a fundamental misunderstanding of the duty of disclosure.

Section 10(b) does not create "an affirmative duty to disclose any and all material information. Disclosure is required . . . only when necessary 'to make . . . statements made, in the light of the circumstances under which they were made, not misleading.'" *Matrixx Initiatives, Inc. v. Siracusano*, —— U.S. ——, 131 S.Ct. 1309, 1321 (2011) (quoting 17 CFR § 240.10b-5(b)). Thus, while a party has a "duty to be both accurate and complete" when it speaks, *Caiola v. Citibank, N.A.*, 295 F.3d 312, 331 (2d Cir. 2002), "revealing one fact about a subject does not trigger a duty to reveal all facts on the subject, so long as what was revealed would not be so incomplete as to mislead," *Richman v. Goldman Sachs Grp., Inc.*, 868 F. Supp. 2d 261, 274 (S.D.N.Y. 2012) (internal quotation marks omitted); *see Glazer v. Formica Corp.*,

964 F.2d 149, 157 (2d Cir. 1992) (Section 10(b) "imposes . . . a duty to disclose only when silence would make other statements misleading or false."). For this reason, courts repeatedly have held that omissions are not actionable under Section 10(b) when omitted information concerns a topic related to, but distinct from, that discussed. *See, e.g.*, *Kleinman*, 706 F.3d at 153-54 (holding that omission in drug trial press release of information regarding patients' "dose response" was non-actionable when the release provided information on patients' reactions to the drug, but did not touch specifically on dose responses); *Richman*, 868 F. Supp. 2d at 274 (issuance of press release responding to news story that mentioned government investigations did not result in duty to disclose defendants' receipt of a Wells notice, because the press release itself did not reference government investigations).

Plaintiffs appear to claim that, by speaking about Penn West's desire to increase its operational efficiency, reduce costs, or improve financial results, Mr. Nunns imposed upon himself to a duty to disclose all matters affecting Penn West's finances, including its accounting practices. The argument stretches the duty to be "accurate and complete" to its breaking point. Were corporate officers required to plumb the minutiae of a company's accounting practices merely by speaking to earnings or cost-control efforts, it would be virtually impossible for executives to discuss financial results. For this reason, there is no duty to disclose information that is at most "tangentially related to the subject matter of a statement." *Monroe Cnty. Emps.' Ret. Sys. v. YPF Sociedad Anonima*, 15 F. Supp. 3d 336, 349 (S.D.N.Y. 2014). Accordingly, Mr. Nunns was not obligated to disclose the accounting practices challenged in the CAC simply because he addressed operating costs and other financial issues.

Even if a duty to disclose existed, Plaintiffs' utter failure to allege any facts showing that Mr. Nunns was aware of the alleged accounting violations at the time of the investor conference

calls would defeat any claim of non-disclosure. As discussed at length above, a defendant may not be held liable for failing to disclose accounting irregularities absent factual allegations "from which a strong inference can be drawn that [the defendant] knew or [was] reckless in not knowing that the accounting . . . at issue was wrong." *In re Bristol-Myers Squibb Sec. Litig.*, 312 F. Supp. 2d at 567-68. "There can be no failure to disclose without knowledge of the facts claimed to have been omitted." *Pachter v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 444 F. Supp. 417, 422 (E.D.N.Y. 1978), *aff'd*, 594 F.2d 852 (2d Cir. 1978).

3. Mr. Nunns Cannot Be Held Liable for Failing to Correct Alleged Misrepresentations of Other Parties.

Plaintiffs' effort to hold Mr. Nunns liable for allegedly "failing to correct false and misleading statements made in his presence" on investor conference calls also fails. (CAC ¶ 312(b); *see* ¶¶ 145, 147, 160, 171, 181, 212.) Section 10(b) imposes liability only on the *maker* of a false statement—i.e., "the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it." *Janus Capital Grp., Inc. v. First Deriv. Traders*, —— U.S. ——, 131 S.Ct. 2296, 2302 (2011) (citing *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N. A.*, 511 U.S. 164 (1994)).

Consistent with this rule, courts repeatedly have held that non-speakers cannot be held liable for statements made by others, whether the allegation is that they failed to correct such statements or somehow assisted in preparing or disseminating them. *See, e.g.*, *Shapiro v. Cantor*, 123 F.3d 717, 720 (2d Cir. 1997) ("[I]f *Central Bank* is to have any real meaning, a defendant must actually make a false or misleading statement in order to be held liable under Section 10(b)." (internal quotation marks omitted)); *Fulton Cnty. Emps. Ret. Sys. v. MGIC Inv. Corp.*, 675 F.3d 1047, 1051-52 (7th Cir. 2012) (defendant did not have "duty to correct" misstatements of others); *United States v. Schiff*, 602 F.3d 152, 167 (3d Cir. 2010) (holding that

the "plain language" of Section 10(b) and Rule 10b-5 "do not contemplate the general failure to rectify misstatements of others"); *Ho v. Duoyuan Global Water, Inc.*, 887 F. Supp. 2d 547, 572 n.13 (S.D.N.Y. 2012) (rejecting argument that one defendant could be held liable for the "failure to correct" a false statement of another defendant as inconsistent with *Janus*); *In re UBS AG Sec. Litig.,* No. 07 Civ. 11225 (RJS), 2012 WL 4471265, at *11 (S.D.N.Y. Sept. 28, 2012) (under *Janus*, "where an Individual Defendant has not 'made' the allegedly material misstatement, he cannot be liable under the Exchange Act"), *aff'd sub nom. City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG*, 752 F.3d 173 (2d Cir. 2014). All claims based on Mr. Nunns' purported "failure to correct" misstatements of other parties must therefore be dismissed.

II. PLAINTIFFS' SECTION 20(A) CLAIM MUST BE DISMISSED.

"The weight of well-reasoned authority is that to withstand a motion to dismiss a [S]ection 20(a) controlling person liability claim, a plaintiff must allege some level of culpable participation at least approximating recklessness in the [S]ection 10(b) context." *Plumbers & Pipefitters Local Union No. 630 Pension-Annuity Trust Fund v. Arbitron Inc.*, 741 F. Supp. 2d 474, 492 (S.D.N.Y. 2010). Because Plaintiffs have failed to allege facts demonstrating that Mr. Nunns acted recklessly or with fraudulent intent, their Section 20(a) claim must be dismissed.

CONCLUSION

For the foregoing reasons and those set forth in the Company Brief, all claims against Murray Nunns should be dismissed with prejudice.

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Respectfully submitted,

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