UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE PENN WEST PETROLEUM LTD. SECURITIES LITIGATION	:	No. 14-cv-6046 (JGK)

DEFENDANTS' REPLY IN FURTHER SUPPORT OF THEIR MOTION TO DISMISS THE CONSOLIDATED AMENDED CLASS ACTION COMPLAINT

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PRELIMINARY STATEMENT

In their 72-page Opposition ("Opp."), through invective, innuendo, and speculation, Plaintiffs try to obscure their failure to plead that Defendants acted "knowingly or with conscious recklessness" in making disclosures about Penn West's operating and capital expenses and other financial metrics. Plaintiffs must employ these tactics, because their Amended Complaint contains *none* of the particularized allegations that courts routinely require under the Private Securities Litigation Reform Act of 1995 (the "Reform Act") to avoid dismissal of a securities fraud claim. Plaintiffs plead no cognizable motive (such as insider trading) for the Individual Defendants to commit fraud and no particularized fact (from, for example, a confidential witness, an internal document, or an internal meeting) "connecting the [I]ndividual [D]efendants to information suggesting unlawful activity within the company." *Plumbers & Pipefitters Loc. Union No. 719 Pension Trust Fund* v. *Conseco Inc.*, 2011 WL 1198712, at *23 (S.D.N.Y. Mar. 30, 2011) (Koeltl, J.).

Since the Reform Act's enactment, courts have repeatedly held that the mere fact that a company announces a restatement—which is "common" in the corporate world, *Goldberg* v. *Household Bank, F.S.B.*, 890 F.2d 965, 967 (7th Cir. 1989)—is legally insufficient to plead securities fraud. Nor is it enough for a plaintiff to couple a company's disclosure of an accounting restatement with speculation that executives engaged in fraud because of their corporate positions or because they departed prior to a restatement's announcement. (*See* cases cited *infra* at 6 to 8 & 10 to 12.)

Thus, misstating Penn West's own disclosures, Plaintiffs repeatedly—and erroneously—claim that the Company has "admitted" that its "senior executives" "perpetrated" and "authorized" "flagrant[] violat[ions]" of applicable accounting rules. (Opp. at 1.) Plaintiffs also repeat baseless speculation that Penn West's accounting restatement was comparable to the

"highly publicized cases of fraud" involving WorldCom and HealthSouth simply because Penn West's restatement involved the capitalization of some operating expenses. (Opp. at 25.)

Hyperbole aside, Penn West's voluntary disclosure about its restatement actually stated that "senior finance and accounting *personnel*," not any executive officer or Individual Defendant, did not classify properly operating and capital expenses. (Ex.[1] 15 (July 30, 2014 Press Release) at 2 (emphasis added).) Plaintiffs speculate that Defendants Todd Takeyasu (Penn West's former CFO) and Jeffery Curran (Penn West's former interim CFO and former Vice President of Accounting and Reporting) were part of this group of unidentified "personnel" (Opp. at 18-20.) But Plaintiffs never explain why, in a large company such as Penn West—with over $12 billion in assets at the end of the putative class period, average annual gross revenue of over $3 billion during the putative class period,[2] and, as Plaintiffs admit, "many" senior finance and accounting personnel (AC ¶ 99)—the CFO and the Vice President of Accounting and Reporting would be responsible for classifying expenses or, in the normal course of business, must have known about errors in those classifications. Likewise, it is legally insufficient for Plaintiffs to assert, without pleading a single particularized fact, that the Individual Defendants knew about these *accounting* errors because reducing operating costs was important to Penn West. (Opp. at 27-29.) And, Plaintiffs cannot plead that Penn West committed securities fraud

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[1] References to Exhibits 1 through 27 are to the Declaration of Robert J. Giuffra, Jr., dated March 6, 2015. (Dkt. No. 87.) References to Exhibits 28 and 29 are to the Supplemental Declaration of Robert J. Giuffra, Jr., dated May 15, 2015.

[2] Ex. 1 (Form 6-K, Ex. 99.1 (Mar. 7, 2014)) at 12; Ex. 6 (Form 40-F, Ex. 99.2 (Mar. 15, 2013)) at 2; Ex. 29 (Form 6-K, Ex. 99.2 (May 1, 2014)) at 1.

by relying on the alleged misconduct of lower level executives who did not make any purported misstatements on the Company's behalf. (*See* cases cited *infra* at 21 to 22.)

Moreover, even after cherry-picking numbers from Penn West's financials to claim that the scope of the Company's accounting errors was "massive" (Opp. at 55), the Amended Complaint makes clear that the overall effect of those errors on what Plaintiffs themselves describe as Penn West's "key" metrics was relatively small over the restated periods (2012, 2013 and the first quarter of 2014)—between 3% and 7% (for funds flow and netback) and 16% to 20% (for operating expenses). (AC ¶¶ 188, 248, 262.) Courts have repeatedly held that restatements of much greater magnitude were insufficient, as a matter of law, to infer that similarly situated corporate executives acted with scienter. (*See* cases cited *infra* at 8 to 10.)

Nor do Plaintiffs plead any particularized facts supporting their speculation (Opp. at 32-33) that Penn West fired Messrs. Takeyasu and Curran because they engaged in accounting fraud. In fact, Penn West's disclosures—on which Plaintiffs otherwise purport to rely—make clear that Messrs. Takeyasu and Curran left Penn West as part of a transition to a new CFO announced more than four months *before* the Company's senior executives learned about the accounting errors. Moreover, it would have made no sense for Penn West's current CEO, Defendant David Roberts—who Plaintiffs allege was part of the fraud—to fire the very executives who allegedly were helping him cover it up. Because executives depart from companies for many reasons, courts routinely reject the notion that departures raise a strong inference of scienter. (*See infra* at 10 to 12.)

When all is said and done, in reflexively trying to convert a restatement into a fraud case, Plaintiffs never seriously contest multiple facts negating their speculation that Defendants acted with scienter, including: (i) the Individual Defendants' lack of any cognizable

motive to engage in fraud, such as insider trading in advance of "corrective disclosures"; (ii) the limited impact of the purported fraud on the Company's "key" financial metrics; (iii) Penn West's mischaracterization of certain *capital* expenses as operating expenses (which would make no sense if Defendants sought to understate operating expenses); (iv) KPMG's consistently clean audit opinions; and (v) Penn West's voluntary review, restatement, and disclosure. When the allegations and judicially noticeable facts are viewed holistically, the more "cogent and compelling" inference, *Tellabs, Inc.* v. *Makor Issues & Rights, Ltd.*, 551 U.S. 308, 324 (2007), is that Defendants reasonably relied on the Company's accounting staff to classify properly expenses, and on its outside auditors to audit that work, and promptly investigated, disclosed, and corrected the errors when they came to the senior executives' attention.

ARGUMENT

I. PLAINTIFFS' OPPOSITION CONFIRMS THAT THEY HAVE NOT PLED, WITH THE REQUIRED PARTICULARITY, A "STRONG INFERENCE" THAT DEFENDANTS ACTED WITH SCIENTER.

A. The Amended Complaint Contains *No* Particularized Allegation That Defendants Had Any Motive To Commit Fraud.

Plaintiffs concede, by their silence, that they have not alleged that any Individual Defendant engaged in insider trading prior to Penn West's announcement of its restatement, the usual means by which securities plaintiffs allege motive. As a result, Plaintiffs are left to assert that the Individual Defendants had a motive to commit fraud because they supposedly "understood that their jobs were in danger unless they could show . . . improving" operating expenses. (Opp. at 36.) But the Amended Complaint contains no such allegation of motive, *see Wright* v. *Ernst & Young LLP*, 152 F.3d 169, 178 (2d Cir. 1998) (rejecting argument that "d[id] not appear anywhere in the amended complaint"), and, in any event, the Second Circuit has long held that "a plaintiff must do more than merely charge that executives aim to prolong the benefits

of the positions they hold" to plead that a corporate officer had a cognizable motive to defraud shareholders. *Shields* v. *Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1130 (2d Cir. 1994).

B. Plaintiffs Have Pled *No* Particularized Facts Showing That Any Defendant Acted With the Required Knowledge or Conscious Recklessness.

Because Plaintiffs have not pled a legally cognizable motive to commit fraud, they must allege particularized facts raising an even "stronger inference," *Kalnit* v. *Eichler*, 264 F.3d 131, 143 (2d Cir. 2001), that "someone whose intent could be imputed to the corporation," *Teamsters Loc. 445 Freight Div. Pension Fund* v. *Dynex Capital, Inc.*, 531 F.3d 190, 194-95 (2d Cir. 2008), was at least "conscious[ly] reckless[]" in making material misstatements or omissions, *S. Cherry St., LLC* v. *Hennessee Grp. LLC*, 573 F.3d 98, 109 (2d Cir. 2009). But Plaintiffs ignore that "conscious recklessness" requires "a state of mind *approximating actual intent*, and *not merely a heightened form of negligence*." *S. Cherry*, 573 F.3d at 109 (citation omitted). Thus, Plaintiffs' unparticularized allegations that the Individual Defendants "should have known" about Penn West's improper accounting practices (Opp. at 3, 4) are legally insufficient to show, as required by the Supreme Court, an inference of scienter that is "more than merely 'reasonable' or 'permissible,'" but rather "cogent and at least as compelling as any opposing inference one could draw from the facts alleged." *Tellabs, Inc.*, 551 U.S. at 324.

Plaintiffs do not dispute that their scienter allegations rely, almost exclusively, on Penn West's own public disclosures about its accounting restatement. They admittedly do not cite in their Amended Complaint any confidential witness, any internal Penn West document, or any internal meeting (*see* Opp. at 47-48), much less particularized facts permitting a "cogent and at least as compelling" inference that any Individual Defendant was consciously reckless in ignoring the relevant accounting errors. *Tellabs, Inc.*, 551 U.S. at 324. Although the Reform Act does not specify what sources plaintiffs must cite to satisfy their burden of pleading scienter

with particularity, every case Plaintiffs do cite for that proposition (Opp. at 47-48) relied on witness statements and internal documents tying the individual defendants to knowledge of the alleged fraud. *See In re AIG Sec. Litig.*, 741 F. Supp. 2d 511, 527 (S.D.N.Y. 2010) (Swain, J.) (allegations outside auditor "warned [defendants] of the possibility that the Company had a material weakness relating to the valuation of the CDS portfolio"); *Sgalambo* v. *McKenzie*, 739 F. Supp. 2d 453, 482 (S.D.N.Y. 2010) (Scheindlin, J.) (allegations of specific internal "test results" reported to defendants); *In re Philip Svcs. Corp. Sec. Litig.*, 383 F. Supp. 2d 463, 472 (S.D.N.Y. 2004) (Mukasey, J.) (allegations outside auditor "expressed concern about certain 'corporate adjustments'" showed defendants' knowledge of accounting errors).

By contrast, as shown below, all the circumstantial "evidence" that Plaintiffs cite in support of their speculative theory of fraud is of the type that courts consider insufficient as a matter of law, even when viewed holistically, to establish a strong inference of scienter.

1. Plaintiffs Cannot Contort Penn West's Voluntary Disclosure of an Accounting Restatement Into an Admission That Messrs. Takeyasu and Curran Engaged In Fraud.

In asking this Court to infer that Messrs. Takeyasu and Curran must have been among the "senior finance and accounting personnel" that Penn West identified as being responsible for its accounting errors, because they were "the Company's two most senior accounting and finance officers" and left the Company prior to the restatement (Opp. at 4, 19), Plaintiffs seek to rewrite the Company's disclosures. Penn West did not mention Messrs. Takeyasu or Curran in these disclosures, much less state that they were among the "senior finance and accounting personnel" involved in the accounting errors. Indeed, Plaintiffs acknowledge that Penn West had sixteen employees in its accounting and finance departments, including "many . . . in senior and managerial roles," who left prior to the restatement. (Opp. at 16; *see also* AC ¶ 99.) But Plaintiffs offer no reason why Messrs. Takeyasu or Curran, as

opposed to these other employees, were directly involved in undertaking or reviewing the classification of expenses. Moreover, the mere fact that an executive is responsible for certain company functions is insufficient to show that the executive acted with scienter in making statements about that function. *See, e.g.*, *Plumbers & Steamfitters Loc. 773 Pension Fund* v. *CIBC*, 694 F. Supp. 2d 287, 300 (S.D.N.Y. 2010) (Pauley, J.) (dismissing complaint, holding allegations that "Chairman and CEO . . . received contradictory information because he 'was ultimately in charge of all CIBC's activities related to subprime exposure' . . . too general"); *see also* Penn West Defendants' Opening Brief ("PW Br.") (Dkt. No. 86) at 19-21 (citing cases).

Likewise, nothing about Penn West's disclosure that the Company's accounting errors "occurred at the corporate level" (which Plaintiffs acknowledge means only that those errors did not occur at a subsidiary (Opp. at 8)), or that "senior accounting management did not adequately establish and enforce a strong culture of compliance and controls" (Ex. 2 (Sept. 18, 2014 Press Release) at 2, 4) suggests that "knowledge of improper accounting practices [was so] widespread" that Messrs. Takeyasu and Curran must have known about those practices. (Opp. at 26-27).[3] Without allegations "from which one could infer that either of the individual defendants

[3] In all the cases on which Plaintiffs rely (Opp. at 26-27), the courts required particularized allegations to show supposedly "widespread" knowledge of a fraud. *See Cornwell* v. *Credit Suisse Grp.*, 689 F. Supp. 2d 629, 637 (S.D.N.Y. 2010) (Marrero, J.) (allegation of "widespread" knowledge supported by "array of 'Confidential Witnesses'" who said "executives reviewed specific reports that should have alerted them to the problems they later allegedly misrepresented"); *In re Scottish Re Grp. Sec. Litig.*, 524 F. Supp. 2d 370, 392 (S.D.N.Y. 2007) (Scheindlin, J.) (allegations of "common knowledge" pled by four confidential witnesses); *In re Alstom Sec. Litig.*, 406 F. Supp. 2d 433, 504 (S.D.N.Y. 2005) (Marrero, J.) ("former ATI project

(*footnote continued…*)

knew or had reason to know anything about the mistaken application of" the applicable accounting rules, allegations of "widespread knowledge" cannot support a strong inference of scienter. *City of Brockton Ret. Sys.* v. *Shaw Grp. Inc.*, 540 F. Supp. 2d 464, 473 (S.D.N.Y. 2008) (McMahon, J.).

2. The Amended Complaint Does Not Contain Particularized Allegations That Penn West Experienced a "Massive" Fraud.

The impact of Penn West's restatement on the Company's financials was not sufficiently large to support a strong inference that any Individual Defendant knew of a fraud. After alleging that Penn West improperly reclassified "at least $625 million worth of operating expenses," Plaintiffs concede that this reclassification occurred "over a seven-year period" (Opp. at 4), and that, over the putative class period (February 2010 to May 2014), this reclassified amount represented less than 16% of the Company's more than $4 billion in announced operating expenses (AC ¶¶ 140, 152, 184, 247, 262). Moreover, the Company's improper accounting practices had a limited impact on "key metrics" of between 3% and 7% (for funds flow and netback), and 16% to 20% (for operating expenses), in each restated period.[4]

(*…continued footnote*)
manager . . . stated that 'everyone' at the Alstom facility . . . including [individual defendants] knew about the cost overruns").

[4] Nor was the impact on these financial metrics alleged to have been significantly greater from 2007 to 2011, when Plaintiffs allege that the same improper accounting practices occurred, but for which no restatement was made. Although Plaintiffs reference an 82% change in net income in 2009 (prior to the putative class period) (Opp. at 30), the Amended Complaint recognizes that "[w]hen evaluating the financial position of oil and gas companies, analysts focus on metrics such as funds flow and operating cash flow *instead* of net income." (AC ¶ 39

(*footnote continued…*)

Net Change in Financial Metric	2012	Change (%)	2013	Change (%)	Q1 2014	Change (%)
Operating Expenses	*Increased* $167MM	16%	*Increased* $172MM	20%	*Increased* $28MM	16%
Net Income	*Decreased* $24MM	(16%)	*Increased* $29MM	3%	*Increased* $7MM	7%
Funds Flow	*Decreased* $66MM	(5%)	*Decreased* $69MM	(7%)	*Decreased* $10MM	(4%)
Netback/boe	*Decreased* $1.13	(4%)	*Decreased* $1.45	(5%)	*Decreased* $1.15	(3%)

(PW Br. at 11-12.)[5]

In fact, the financial impact from Penn West's accounting restatement was well below the magnitude that courts have found to be "dramatic" enough to support a strong inference of scienter. *See In re Turquoise Hill Res. Ltd. Sec. Litig.*, 2014 WL 7176187, at *7 (S.D.N.Y. Dec. 6, 2014) (Schofield, J.) (alleged "substantial" overstatement of revenue by 32%

(…*continued footnote*)
(emphasis added).) At the same time, for 2009, the Amended Complaint alleges only a 12% impact on operating expenses and 7% and 8% impact on netback and funds flow, respectively. (AC ¶ 134.)

[5] Plaintiffs exaggerate the impact on operating expenses and funds flow during these restated periods by selectively singling out certain *quarterly* restatement corrections, while ignoring the lesser overall *annual* corrections. (*See* Opp. at 30.)

and 36% over two-year period not so dramatic as to "suggest knowledge or intent to misstate"); *see also* PW Br. at 25-27 (collecting cases).[6]

3. The Departures of Messrs. Takeyasu and Curran Do Not Support Any Inference of Scienter.

Plaintiffs' speculation that, because Messrs. Takeyasu and Curran left Penn West "without any explanation," they must have been fired because of their involvement in the alleged fraud (Opp. at 32-33, 40-41) is not supported by any particularized allegations. *See In re Openwave Sys. Sec. Litig.*, 528 F. Supp. 2d 236, 251 (S.D.N.Y. 2007) (Cote, J.) (dismissing complaint, stressing that it "[did] not include a single fact linking [the CEO's] resignation to the alleged fraud or his knowledge thereof"). To the contrary, Penn West announced a transition of CFOs from Mr. Takeyasu to Mr. Dyck *more than four months* before the Company began its accounting review in July 2014. Specifically, on March 24, 2014, the Company announced that Mr. Dyck "ha[d] been appointed Senior Vice President and Chief Financial Officer

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[6] Plaintiffs' contention that courts have found a strong inference of scienter based on "comparable" restatements (Opp. at 30-31) misstates case law. *See Plumbers & Pipefitters Nat'l Pension Fund* v. *Orthofix Int'l N.V.*, 2015 WL 981518, at *13 (S.D.N.Y. Mar. 6, 2015) (Koeltl, J.) (company's restated financials resulted in a "1600% decrease" in net income for one year alone); *In re New Oriental Educ. & Tech. Grp. Sec. Litig.*, 988 F. Supp. 2d 406, 426 (S.D.N.Y. 2013) (Koeltl, J.) (defendants' alleged misrepresentation of a company's corporate relationship with its foreign affiliate that accounted for "between 62% and 67% of . . . assets and between 97% and 98.9% of . . . revenues"); *In re MicroStrategy, Inc. Sec. Litig.*, 115 F. Supp. 2d 620, 636 (E.D. Va. 2000) (company's "'breathtaking'" restatement reversed three years of reported "record" net income to *net losses*, resulting in a decline in net income of 290.5%).

('CFO') . . . effective May 1, 2014," and that Mr. Takeyasu was "stepping down." (Ex. 14 (Mar. 24, 2014 Press Release) at 1.) Mr. Curran was to "fulfill the responsibilities of CFO in the interim period ensuring an orderly transition." *Id.* Plaintiffs allege Mr. Curran had left the Company "as of June 2014." (AC ¶ 99.) According to the November 2014 *Financial Post* article on which Plaintiffs rely (Opp. at 41 (citing AC ¶ 98)), Mr. Dyck did not inform Penn West's CEO David Roberts of "concerns about accounting practices" until July 2014, and Penn West announced the start of its internal accounting review that same month (Ex. 28 (Nov. 21, 2014 Financial Post Article) at 1). Thus, it is not plausible to conclude that Mr. Takeyasu or Mr. Curran was dismissed because of his participation in any improper, but not yet uncovered, accounting practices.

Moreover, if, as Plaintiffs allege, Mr. Roberts was part of an alleged "wide-ranging, years-long fraud" (Opp. at 39), it would make no sense for him to fire Messrs. Takeyasu and Curran, who allegedly were helping to conceal the fraud. Similarly, if Mr. Roberts fired Mr. Takeyasu for being part of the alleged fraud, he presumably would not have replaced him with Mr. Curran, who allegedly also was part of the fraud. (PW Br. at 9.)

This Court's recent ruling in *Orthofix*, which Plaintiffs cite, recognizes that although "the timing and circumstances of individual defendants' resignations *may* add *some* further weight to an overall inference of scienter," 2015 WL 981518, at *14 (emphasis added), a plaintiff still must make particularized allegations that management knew of the improper accounting practices. Unlike here, in *Orthofix*, this Court relied on plaintiffs' specific allegations that the CFO "attended a meeting" where "Orthofix representatives discussed their concerns" about fast-increasing receivables, and the CFO "told everyone at that meeting not to raise any

questions discussed at the meeting at a subsequent training meeting with Ernst & Young on revenue recognition practices." *Id.* at *5 (citing confidential witness).[7]

4. Plaintiffs' Remaining Hodgepodge of Allegations Does Not Sustain Their Burden of Pleading Scienter.

a. The Amended Complaint's Allegations About Mr. Dyck's Discovery of the Errors Reflect, At Most, Mismanagement.

The speed with which Penn West's new CFO David Dyck allegedly "learned of the fraud" after his arrival "as a complete outsider" (Opp. at 2) does not support an inference of

[7] The remaining cases that Plaintiffs cite for the proposition that the positions held by Messrs. Takeyasu and Mr. Curran and their departures support a strong inference of scienter involved either accounting errors of much greater magnitude than here, *In re Am. Bank Note Holographics, Inc. Sec. Litig.*, 93 F. Supp. 2d 424, 446-48 (S.D.N.Y. 2000) (McMahon, J.) ("extraordinary . . . magnitude of the accounting irregularities," which inflated revenues "by over 50%"), or specific allegations about discussions or information that the CFO received (often from confidential witnesses), *In re OSG Sec. Litig.*, 12 F. Supp. 3d 622, 631-32 (S.D.N.Y. 2014) (Scheindlin, J.) (former employee alleged defendant CFO "understood the implications of [the tax code] liability"); *Freudenberg* v. *E*Trade Fin. Corp.*, 712 F. Supp. 2d 171, 197 (S.D.N.Y. 2010) (Sweet, J.) ("numerous confidential witnesses" and "[c]orroboration from multiple sources"); *In re Alstom SA*, 454 F. Supp. 2d 187, 206-08 (S.D.N.Y. 2006) (Marrero, J.) (executive admitted he prepared reports about problems, discussed reports with management at meetings, and company announced same executive was "suspended pending the completion of an internal review"); *In re AOL Time Warner, Inc. Sec. & "ERISA" Litig.*, 381 F. Supp. 2d 192, 221-22 & n.30 (S.D.N.Y. 2004) (Kram, J.) (defendant CFO "was a member of the Operating Committee," which "met weekly" to discuss "the downturn in AOL's advertising business").

scienter against the Individual Defendants. To the contrary, the very Penn West disclosures on which Plaintiffs rely for this allegation specifically state that the Company's accounting deficiencies went "undetected" prior to "c[o]m[ing] to the attention of" Mr. Dyck (Ex. 15 (July 30, 2014 Press Release) at 1), and Plaintiffs fail to allege, with particularity, that any Individual Defendant knew of those practices before Mr. Dyck discovered them. In fact, Plaintiffs concede that members of Mr. Dyck's "team" "approached *him*" with concerns about the accounting errors, but they never allege that those concerns were expressed previously to any Individual Defendant. (Opp. at 2 (emphasis added).) Tellingly, Plaintiffs cite no law for the proposition that, merely because a subsequent CFO is alerted to accounting deficiencies, knowledge of those deficiencies is attributable to the prior CFOs. In fact, the two cases Plaintiffs do cite suggest exactly the opposite.

In *George* v. *China Automotive Systems, Inc.*, Judge Forrest *dismissed* a securities fraud action against an auditor, finding no strong inference of scienter, even though a replacement auditor discovered errors "within three months of taking over." 2012 WL 3205062, at *14 (S.D.N.Y. Aug. 8, 2012). And in *In re New Century*, where the court noted that a new CEO's discovery of accounting problems "within months" suggested those problems "were obvious enough that a new officer found them," the complaint there (unlike here) cited multiple confidential witnesses who stated that individual defendants had instructed employees to lower lending standards, and those defendants "had access to information on the effects of these practices, including the rising defaults." 588 F. Supp. 2d 1206, 1229-31 (C.D. Cal. 2008).

At best, Plaintiffs have pled facts showing that Mr. Dyck and his team may have done a better job than Messrs. Takeyasu and Curran in uncovering problems in Penn West's expense accounting, but such allegations provide no basis for a securities fraud claim.

b. The Fact That Penn West's Restatement Concerned a Reclassification of Expenses Does Not Sufficiently Plead Scienter.

Plaintiffs point to Penn West's use of the term "reclassification" in its disclosures about the restatement, which Plaintiffs speculate means that "senior management personally went into (or instructed others to go into) Penn West's books and changed entries that had been [correctly classified] in the first instance." (Opp. at 23.) This speculation, however, does not sustain Plaintiffs' pleading burden as a matter of law.

First, even though Penn West's disclosures attributed the accounting errors to "senior finance and accounting personnel" (Ex. 15 (July 30, 2014 Press Release) at 2), Plaintiffs misleadingly use the term "senior management" (*e.g.*, Opp. at 8, 10, 16, 18-19, 25-28) to suggest that Penn West has admitted that its executive level officers (*i.e.*, the Individual Defendants) participated in the accounting errors. Plaintiffs engage in this sleight of hand to mask their failure to plead any *particularized* facts linking any *specific* Individual Defendant to (i) the misclassification of expenses, or (ii) knowledge of those misclassifications.

Second, in relying on Penn West's statement that "senior accounting management overrode" certain capital cost accruals and oil and gas volumes (Opp. at 23), Plaintiffs ignore that their Amended Complaint does not allege that the Company's errors in accounting for items affected by these overrides had anything to do with Penn West's misclassification of expenses or had any material effect on Penn West's financials. (*See* PW Br. at 13, n.6.) Plaintiffs thus ignore that this Court must "evaluate [P]laintiff[s'] allegations of scienter with respect to each" accounting practice that they claim was fraudulent. *In re BISYS Sec. Litig.*, 397 F. Supp. 2d 430, 442 (S.D.N.Y. 2005) (Kaplan, J.) (scienter alleged where confidential witnesses stated that "management, including the Company's regional vice president, intentionally 'pressur[ed] sales representatives to artificially increase the amount of revenues booked from insurance policies'").

c. Courts Hold That Violations of GAAP and Internal Policies Cannot Support a Strong Inference of Scienter.

Plaintiffs do not contest that "[a]llegations of a violation of GAAP provisions . . . without corresponding fraudulent intent, are not sufficient to state a securities fraud claim." *Chill* v. *Gen. Elec. Co.*, 101 F.3d 263, 270 (2d Cir. 1996). Even so, they still claim that scienter can be inferred from the facts pled here, because the GAAP violations were "clear-cut" and violated Penn West's own internal policies. (Opp. at 23-24.) As Judge Kaplan held in *In re BISYS*, however, "allegations that the Company's financial reports violated GAAP or their own internal policies merely establish that the reports were false. They do not establish that the Individual Defendants issued those reports with the requisite fraudulent intent." 397 F. Supp. 2d at 448. Judge Kaplan rightly recognized that "the Company's misleading financial reports . . . could well be products of negligence or mismanagement," not fraud. *Id.* The same is true here.

Plaintiffs' reliance on this Court's *Orthofix* decision (Opp. at 23-24) is similarly misplaced, because this Court did not rely on the GAAP violation in that case—recognizing revenue before it "is realized or realizable and earned"—to find scienter had been adequately pled. 2015 WL 981518, at *11, 13 (internal quotations omitted). Rather, this Court relied on the allegations—not pled here—of multiple confidential witnesses concerning specific meetings that the senior executives attended and documents they saw. *Id.* at 9-10, 12.[8]

[8] The other cases that Plaintiffs cite (Opp. at 23-24, 31) are equally off point. *See S.E.C.* v. *Egan*, 994 F. Supp. 2d 558, 566 (S.D.N.Y. 2014) (Pauley, J.) (company executive was "active participant in" software lease negotiations and reviewed "acceptance letter, the memorandum of understanding, and an 'actual sales and profit' statement" that revealed improper accounting); *In re MicroStrategy*, 115 F. Supp. 2d at 644-46 (scienter sufficiently pled by allegations that

(*footnote continued…*)

d. There Was No "Acceleration" of the Accounting Errors.

Plaintiffs' speculation that "Defendants accelerated their accounting fraud when the Company faced downward financial pressures" (Opp. at 31-32, 51-52) is not supported by any particularized facts. Although the Amended Complaint alleges that Penn West increased its reclassifications in 2009 in response to falling oil prices (AC ¶¶ 59-61), oil prices actually *increased* dramatically during 2009. (*See* Ex. 23 (Chart of WTI Crude Prices)).

To try to save this theory, Plaintiffs now claim that Defendants increased the misclassification of expenses during 2009 because oil prices that year remained lower than pre-financial crisis highs. (Opp. at 51.) But that speculation misses the point: had Defendants misclassified operating expenses based on oil prices, it would have made sense to do so when oil prices were falling (in 2008), not when they were recovering (in 2009).

Likewise, Plaintiffs' theory that Defendants increased reclassifications *in 2012* due to "operational difficulties" makes no sense, because the Amended Complaint only identifies "difficulties" that occurred *in 2011*. (*See* PW Br. at 28-29.) Moreover, Penn West's restatement indicates that in 2011, when the Company allegedly experienced operational difficulties, Penn West *understated* capital expenses and *understated* net income,[9] which would have been illogical if Penn West was trying to understate operating expenses by capitalizing them.

(…*continued footnote*)
"private sales of stock by the Individual Defendants occurred within days after an announcement that the Company showed . . . consecutive quarter[s] of increased revenue").

[9] Specifically, Penn West disclosed in its restatement that in 2011 Property Plant & Equipment actually *increased* by $4 million over what the Company originally reported. (Ex. 16 (Restated Form 40-F, Ex. 99.2 (Sept. 18, 2014)) at 14.) This suggests an *overstatement* of

(*footnote continued*…)

e. This Court Has Already Held That a Defendant's Certification of Financial Statements Is Insufficient To Plead Scienter.

As this Court held in *Orthofix*, Plaintiffs cannot raise a strong inference of scienter against corporate executives "based on the signing of a certification without alleging any facts to show a concomitant awareness of or recklessness to the materially misleading nature of the statements." 2015 WL 981518, at *9 (citation omitted). Plaintiffs here make no such showing. Indeed, in one of the cases Plaintiffs cite, *Dobina* v. *Weatherford International Ltd.*, Judge Kaplan found a strong inference of scienter against a CFO, not because of a due diligence duty arising from the CFO's signing the company's financials, but because confidential witnesses actually stated that the CFO was personally informed of deficiencies in the company's controls. 909 F. Supp. 2d 228, 245-48 (S.D.N.Y. 2012).[10]

(…*continued footnote*)
operating expenses at the exact time when Plaintiffs contend the Company had the greatest motivation to do just the opposite. (Opp. at 31-32.) It is unsurprising, therefore, that Plaintiffs studiously ignore the restatement's effect in 2011.

[10] The two cases Plaintiffs cite for the proposition that a lack of "adequate internal controls" alone supports scienter (Opp. at 35, n.10) bear no resemblance to this case. *See Hall* v. *The Children's Place Retail Stores, Inc.*, 580 F. Supp. 2d 212, 223, 232-33 (S.D.N.Y. 2008) (Scheindlin, J.) (individual defendant "admittedly violated the Company's internal control policies by pledging shares of his common stock as collateral for margin loans in his brokerage account during a black-out period"); *In re Veeco Instruments, Inc. Sec. Litig.*, 235 F.R.D. 220, 231-32 (S.D.N.Y. 2006) (McMahon, J.) (individual defendant allegedly directed confidential witness to book improper entries, and company "loosen[ed] . . . accounting control[s]" by reducing accounting staff by 75%).

* * *

Without any particularized allegations of fraud, Plaintiffs must speculate—impermissibly—that the Individual Defendants "knew or should have known" about the accounting errors simply because they were senior executives at Penn West and, like for any company, the level of Penn West's operating expenses were relevant to its financial success. As this Court has recognized, even when information is "of crucial importance" or at the "core" of a company's business, knowledge of that information is not necessarily attributable to senior officers. *Plumbers & Pipefitters Loc. Union No. 630 Pension-Annuity Trust Fund* v. *Arbitron, Inc.*, 741 F. Supp. 2d 474, 490 (S.D.N.Y. 2010) (Koeltl, J.) (observing that every court of appeals to address the "core operations" doctrine "ha[s] found that it is no longer viable in most situations" (citations omitted)).[11]

C. When All of the Allegations and Judicially Noticeable Facts Are Examined Together, the Far More "Cogent and Compelling" Inference Is That the Individual Defendants Did Not Act With Scienter.

Even if it were possible to draw any inference of fraudulent intent from Plaintiffs' unparticularized assertions—and it is not—the far more cogent and compelling inference is that the Individual Defendants reasonably relied on personnel in Penn West's

[11] Courts in this Circuit that have applied the so-called "core operations doctrine" have held that it "constitute[s] supplementary but not independently sufficient means to plead scienter," *In re Wachovia Equity Sec. Litig.*, 753 F. Supp. 2d 326, 353 (S.D.N.Y. 2011) (Sullivan, J.), and cases Plaintiffs cite that relied on this doctrine (Opp. at 28) involved allegations, not present here, that senior executives knew of, but misrepresented, their company's relationship with its largest customers. *E.g.*, *In re Complete Mgmt. Inc. Sec. Litig.*, 153 F. Supp. 2d 314, 319, 325 (S.D.N.Y. 2001) (Buchwald, J.) (misrepresentations involved "largest single client").

accounting department to characterize Penn West's expenses, and on its outside auditors to audit that work, and corrected the accounting errors promptly after they became known:

***No Cognizable Motive*:** Plaintiffs have failed to answer the basic question why the Individual Defendants would risk the serious consequences to their careers (and potentially their freedom) of engaging in a supposedly "massive" fraud (AC ¶ 126) without any concrete benefit for themselves. *See City of Livonia Emp. Ret. Sys. & Local 295/Local 851* v. *Boeing Co.*, 711 F.3d 754, 758 (7th Cir. 2013) (Posner, J.) (affirming dismissal of fraud claim, stressing that "[w]ithout a motive to commit securities fraud, businessmen are unlikely to commit it").

***Accounting Errors Inconsistent with Fraud*:** Plaintiffs do not dispute that some of the deficient accounting practices (such as reclassifying operating expenses as royalties) had *no effect* on funds flow or netback, two of the supposedly "key metrics" that the fraud was intended to inflate. (PW Br. at 11-12.) Indeed, Penn West misclassified certain capital expenditures as operating expenses, thereby *overstating* operating expenses by at least $129 million. (Ex. 16 (Restated Form 40-F, Ex. 99.3 (Sept. 18, 2014)) at 14.) To evade these uncontestable facts, Plaintiffs simply speculate—with no support in the Amended Complaint—that "lower level employees" were responsible for "'incorrectly classified' capital expenditures." (*See* Opp. at 45-46.) In other words, Plaintiffs alternatively and improperly speculate that Penn West's accounting errors were committed by either (i) "senior management" or (ii) "lower level employees," depending on whatever speculation best helps Plaintiffs' theory of fraud in responding to a particular argument.

***No Auditor Resignation*:** In its uniformly clean audit opinions, Penn West's outside auditor, KPMG, repeatedly made representations to Defendants about the accuracy of Penn West's financial statements and adequacy of its internal controls. (PW Br. at 7); *see*

Turquoise Hill, 2014 WL 7176187, at *6 (no inference of scienter where no allegation "Turquoise Hill's auditors disapproved of . . . accounting practices or found any lack of internal controls").[12]

***Penn West's Voluntary Review, Disclosure, and Restatement*:** Penn West's actions after Mr. Dyck learned of the Company's improper expense accounting in 2014 also support the inference that the Defendants did not engage in fraud. As this Court recognized in *In re New Oriental*, the "formation of an independent committee to investigate potential" improprieties within a company "provide[s] some evidence of non-fraudulent intent," when the company "demonstrates a commitment to addressing fraudulent activity." 988 F. Supp. 2d at 427. Here, as reflected in the very disclosures on which Plaintiffs otherwise rely, Penn West voluntarily initiated an independent review of the Company's accounting practices, restated its financial statements, promptly reported to regulators and investors the review's findings, and began "implementing the appropriate remedial measures to strengthen [the Company's] corporate governance, compliance and control processes." (Ex. 2 (Sept. 18, 2014 Press Release) at 1-2, 4; *see also* PW Br. at 31.)[13]

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[12] Contrary to Plaintiffs' contention, Defendants do not argue that KPMG's clean audits mean that Defendants "are immune from liability." (Opp. at 46-47.) Rather, such audits raise an inference *against* a finding that scienter has been pled here.

[13] Plaintiffs contend that after Mr. Dyck learned of the accounting errors, it was no longer "voluntary" for Penn West to restate its financials. (Opp. at 44-45.) But Plaintiffs miss the point: the accounting errors were not identified by a government regulator, outside auditor, or the media. Rather, Penn West's senior executives and directors, including Defendant David

(*footnote continued…*)

D. Because Plaintiffs Fail To Plead Scienter Against Any Individual Defendant, They Cannot Plead Scienter Against Penn West.

Relying on *Dynex*, Plaintiffs assert that, because they have pled that some (unnamed) "senior finance and accounting personnel" knew about the accounting errors, they also "have sufficiently pled Penn West's scienter" even without pleading a "strong inference" of scienter against any Individual Defendant. (Opp. at 37-38.) But the general rule is that "a defendant corporation is deemed to have the requisite scienter for fraud *only if the individual corporate officer making the statement has the requisite level of scienter*." *Kinsey* v. *Cendant Corp.*, 2004 WL 2591946, at *13 (S.D.N.Y. Nov. 16, 2004) (Sweet, J.) (emphasis added and citations omitted); *see Dynex*, 531 F.3d at 195 ("In most cases, the most straightforward way to raise such an inference for a corporate defendant will be to plead it for an individual defendant"); *see also Glazer Capital Mgmt., LP* v. *Magistri*, 549 F.3d 736, 745 (9th Cir. 2008) ("PSLRA requires Glazer to plead scienter with respect to those individuals who actually made the false statements in the merger agreement"); *Southland Sec. Corp.* v. *INSpire Ins. Solutions, Inc.*, 365 F.3d 353, 366 (5th Cir. 2004) (to plead strong inference of scienter against corporation, courts must "look to the state of mind of the individual corporate official or officials who make or issue the statement (or order or approve it or its making or issuance, or who furnish information or language for inclusion therein, or the like) rather than generally to the collective knowledge of all the corporation's officers").

Moreover, Penn West's deficient accounting did not have anywhere near the type of transformative "dramatic" impact on the Company that the Second Circuit in *Dynex* stated

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(…*continued footnote*)
Roberts, the Company's current CEO, on their own, investigated the reported errors, publicized them, and restated the Company's financials.

might be sufficient to infer scienter against a corporation without establishing scienter against any particular officer. *See* 531 F.3d at 195-96 ("Suppose General Motors announced that it had sold one million SUVs in 2006, and the actual number was zero.").[14]

Accordingly, Plaintiffs have not pled scienter here.

II. PLAINTIFFS CONCEDE THAT CERTAIN OF THE ALLEGED MISSTATEMENTS ARE INACTIONABLE EXPRESSIONS OF OPINION.

In their Opposition, Plaintiffs either acknowledge[15] or implicitly concede[16] that certain of the alleged misstatements are not actionable expressions of opinion. (*See* Opp. at 55-58

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[14] The other cases on which Plaintiffs rely involved misstatements of vastly larger segments of a company's business, or particularized allegations against individual executives. *See Sgalambo*, 739 F. Supp. 2d at 453 (scienter pled where complaint "satisfactorily identifie[d] specific reports or documents that would have indicated that [t]he Officers' public statements . . . were inaccurate"); *In re MBIA, Inc., Sec. Litig.*, 700 F. Supp. 2d 566, 591 (S.D.N.Y. 2010) (Karas, J.) (corporate officers represented they "carefully reviewed" underlying debt for $8.1 billion of collateralized debt obligations); *In re Marsh & McLennan Cos., Inc. Sec. Litig.*, 501 F. Supp. 2d 452, 482-83 (S.D.N.Y. 2006) (Kram, J.) (alleged misstatements involving work that "generat[ed] approximately sixty percent" of company's revenues, and confidential witnesses stated that "employees openly discussed" improper steering agreements at meetings and "managers encouraged" such practices in emails).

[15] Specifically, Defendants' (i) "*belie[f]* that the Company's new strategic focus and culture" will deliver certain results (AC ¶ 231 (emphasis added)); and (ii) "*goal* to deliver best in class operating performance" (AC ¶ 215 (emphasis added)) are inactionable. (Opp. at 56, n.22.)

& App. A.) As to the remaining challenged statements (AC ¶¶ 160, 164, 178, 242), Plaintiffs contend there is no need to allege Defendants' subjective disbelief because those statements were "statements of fact" (Opp. at 56-58), or because the Supreme Court in *Omnicare, Inc.* v. *Laborers District Council Construction Industry Pension Fund*, 135 S. Ct. 1318 (2015), altered previous Second Circuit precedent. Plaintiffs are wrong.

First, these were statements of opinion, not of fact, because they expressed either the speaker's "belie[f]" about Penn West's ability to meet general goals, *see Omnicare*, 135 S. Ct. at 1325 ("[a]n opinion is 'a belief'" which does not express certainty), or an Individual Defendant's general corporate "aim" or "vision," *see In re Lululemon Sec. Litig.*, 14 F. Supp. 3d 553, 578 (S.D.N.Y. 2014) (Forrest, J.) (statement that "[w]e have been building capacity in the product organization, and we recognize that continued investment . . . is required" is one of "goals or beliefs").[17] Because Plaintiffs have not sufficiently pled that any Individual Defendant

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(…*continued footnote*)

[16] Specifically, statements that (i) "[o]ne of the key strategies in our long-term plan is cost reduction" (AC ¶ 250); (ii) Penn West will "take further steps to allow us to achieve our *goal* to deliver best in class operating performance and shareholder returns." (AC ¶ 219 (emphasis added)); and (iii) "*we believe* we can achieve [a 30% to 40% cost reduction]" (AC ¶ 143 (emphasis added)).

[17] Specifically, statements that (i) Nunns "*believ[ed]*" Penn West "ha[d] the capacity internally to" "meet [its] CapEx guidance" (AC ¶ 164 (emphasis added)); (ii) Penn West was "committed to optimiz[e] . . . operational efficiencies" and has taken measures to "ensure balance sheet integrity" (AC ¶ 178); (iii) Penn West has a "new vision" which includes the

(*footnote continued…*)

did not subjectively believe these statements when made, the statements are not actionable as a matter of law. (*See* PW Br. at 33.) *Second*, under *Omnicare*, Plaintiffs cannot turn opinions into actionable statements without pleading "particular (and material) facts" that Defendants lacked a good faith basis for stating their opinions. 135 S. Ct. at 1332. Plaintiffs have not done so here.

III. PLAINTIFFS STILL SHOW NO CONNECTION BETWEEN PENN WEST'S NOVEMBER 6, 2013 ANNOUNCEMENT AND THE ALLEGED ACCOUNTING FRAUD.

To try to pump up their claimed damages, Plaintiffs inject Penn West's November 2013 disclosure of quarterly earnings and a strategic review into this action. But Plaintiffs cannot avoid their duty to plead "a 'causal connection' between the material misrepresentation and the loss" supposedly caused by that announcement merely by asserting that loss causation is a factual issue. (Opp. at 67-68, 70-71; *see* PW Br. at 34-35 (collecting cases)); *Strougo* v. *Barclays PLC*, 2015 WL 1883201, at *12 (S.D.N.Y. Apr. 24, 2015) (Scheindlin, J.) (dismissing claim based on purported "corrective disclosure" as a matter of law).

Plaintiffs contend that Penn West's November 2013 disclosure about "higher than expected operating costs" (AC ¶ 85) revealed "the truth about the magnitude of the problem Penn West was facing with respect to its cost structure" (Opp. at 69). But Plaintiffs plead no facts connecting Penn West's higher-than-expected quarterly operating expenses *in November 2013* with Penn West's disclosures of accounting errors nearly nine months later on July 29, 2014. Indeed, Plaintiffs contradictorily contend that Penn West was still hiding its true operating costs in November 2013. (AC ¶¶ 236, 238-41.) Plaintiffs cannot avoid this pleading defect by

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(…*continued footnote*)
"application of best-in-class operating practices" (AC ¶ 242); and (iv) "*aim[s]* . . . to provide the Company with funds flow certainty" (AC ¶ 160 (emphasis added)).

trying to characterize the November 2013 announcement as a "partial[] revel[ation]" (AC ¶ 89), because, again, the Amended Complaint does not allege that this announcement revealed *anything* about the Company's accounting errors. *See In re Bausch & Lomb, Inc. Sec. Litig.*, 592 F. Supp. 2d 323, 347 (W.D.N.Y. 2008) (loss causation not pled in connection with disclosure of six accounting irregularities, because nothing "suggest[s] that the market perceived [that the corporation's] press release" announcing a restatement concerned these items).[18]

CONCLUSION

For the foregoing reasons, this Court should dismiss the Amended Complaint. The Court should do so with prejudice, because Plaintiffs have already amended their claims once, passed on their opportunity to amend again (*see* Stipulation and Order Concerning Briefing of Defendants' Motions to Dismiss, Dkt. No. 78 at 1), and have not requested leave to amend in their Opposition.

[18] Plaintiffs have no basis to rely on *In re Vivendi Universal, S.A. Securities Litigation* (Opp. at 68-70), which did not involve a restatement, and thus "[wa]s not a case of corrective disclosure." 605 F. Supp. 2d 586, 601 (S.D.N.Y. 2009) (Holwell, J.). Moreover, the *Vivendi* plaintiffs alleged a "broad[], materialization-of-the-risk theory" whereby defendants concealed risks about a company's ability to service debt, which were revealed by "quick, unexpected asset sales or credit rating downgrades." *Id*. at 592-93, 601. Here, Plaintiffs do not allege any "risk" concealed by Penn West's accounting practices materialized in the November 2013 announcement, because the Amended Complaint never links the accounting errors to the higher-than-expected operating expenses reported in the third quarter of 2013.

Respectfully,

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