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Case Number 338,2020

IN THE SUPREME COURT OF THE STATE OF DELAWARE

OTTO CANDIES, LLC, et al.,	)	
	)	No. 338, 2020
Plaintiffs Below-Appellants,	)	
	)	
v.	)	CASES BELOW:
	)	
KPMG LLP,	)	COURT OF CHANCERY
	)	OF THE STATE OF DELAWARE
Defendant Below-Appellee.	)	C.A. No. 2018-0435-MTZ
	)	
	)	SUPERIOR COURT OF THE
	)	STATE OF DELAWARE
	)	C.A. No. N16C-02-260-PRW
	)	(CCLD)

APPELLANTS' OPENING BRIEF

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NATURE OF PROCEEDINGS

Plaintiffs, investors and family-owned businesses (including Delaware companies), brought negligent misrepresentation claims against Delaware-incorporated auditor KPMG LLP ("KPMG-US") and its affiliates for failing to adequately audit Citigroup Inc. (a Delaware corporation), Citigroup's subsidiary Banco Nacional de Mexico ("Banamex"), and Oceanografía ("OSA"). Plaintiffs are creditors of OSA, a now-bankrupt oil-services company, who relied on Defendants' audits when they sold or leased vessels to OSA, purchased its bonds, or loaned it money. A247.

Defendants failed to detect and prevent an extraordinary but crude fraud—and to adequately audit the internal control deficiencies that allowed it to happen—involving a "cash-advance" facility through which Citigroup/Banamex provided hundreds of millions of dollars to OSA on the basis of forged invoices for work OSA had not yet performed for Petroleos Mexicanos ("Pemex"), Mexico's government-owned oil company. Plaintiffs allege that Defendants, as the auditors of not just one, but *all* of the companies involved, were uniquely positioned to detect the scheme. Indeed, the Securities and Exchange Commission ("SEC") found internal accounting control failures at Citigroup connected to this very fraud. When the scheme was exposed, OSA collapsed and left Plaintiffs with over $1.1 billion in damages.

The Superior Court ruled that it lacked subject-matter jurisdiction to hear negligent misrepresentation claims, and Plaintiffs re-filed their complaint in the Court of Chancery. A85-86. On February 28, 2019, the Court of Chancery dismissed the claims against KPMG Cardenas Dosal ("KPMGM") and KPMG International ("KPMGI") for lack of personal jurisdiction and against KPMG-US on the merits. Ex. E.[1] The Court of Chancery permitted Plaintiffs to amend their Complaint, which Plaintiffs did, bolstering the factual allegations and alleging negligent misrepresentation against KPMG-US for KPMGM's OSA audit opinions (Count I), among other counts not at issue in this appeal. A244,423-28.

On August 21, 2020, the Court of Chancery dismissed Count I under Rule 12(b)(6), solely based on the reasoning that the Amended Complaint failed to adequately allege vicarious liability for KPMG-US based on agency or joint venture, and that these issues generally should be decided on the pleadings. Ex. F (hereinafter "Op.") 22-37, 51-53. As explained below, this Court should reverse because Plaintiffs adequately allege facts establishing all elements of agency and joint

[1] Plaintiffs do not appeal the judgment as to KPMGI and KPMGM. However, to the extent the rulings on jurisdiction and jurisdictional discovery "color[ed the Court of Chancery's] analysis" on the merits of the claims against KPMG-US, Ex. F at 13 n.52, those rulings are erroneous for the same reasons as the merits ruling. *Infra* 15-42.

venture, the Court of Chancery did not find that any of these facts were not reasonably conceivable, and nothing more is required at the pleading stage.

SUMMARY OF ARGUMENT

I. The Amended Complaint alleges vicarious liability for KPMG-US based on a sub-agency relationship, whereby KPMGM is an agent of KPMGI, and KPMGI is an agent KPMG-US. The Court of Chancery held that the allegations establishing the right to control KPMGM did not suffice given the supposed lack of allegations showing actual exercise of control over KPMGM's OSA audits. However, this Court has held repeatedly that agency does not require the principal's *exercise* of control over the agent, but only the *right* to control the agent. Thus, the dismissal is based on a fundamental error of law. That error (if not corrected) would put Delaware law at odds with well-established law across the country and would effectively nullify the agency doctrine. The Court of Chancery committed a further legal error in holding that agency should be decided on a motion to dismiss and demanding particularized evidence that far exceeds what other courts have required even at summary judgment. Indeed, courts consistently recognize that detailed allegations of agency are not required at the pleading stage because the underlying facts are typically within the defendant's exclusive control. Applying the correct legal standards, the factual allegations here make it far more than reasonably conceivable that KPMG-US had a right to control KPMGI, and that KPMGI had a right to control KPMGM, thus establishing an agency relationship sufficient for vicarious liability. As alleged in the Amended Complaint, KPMG-US officials had

many top-level positions within KPMGI; KPMG-US had outsized importance and power within KPMGI; and KPMG-US is responsible for inspections of KPMG auditors. KPMGI, in turn, had the right to control KPMGM because it established the policies, procedures, and methodology governing KPMGM's audits, and KPMGI had the power to impose disciplinary measures for non-compliance. The allegations of control are especially strong for KPMGM's OSA audits, given that KPMG-US and KPMGM audited the other side of the very same transactions. These allegations are far more extensive than the simple "close connection" that courts typically find sufficient to support agency at the pleading stage. And, specifically in the audit context, courts have accepted materially identical allegations in support of agency, even at summary judgment. Accordingly, the Amended Complaint states a claim based on agency, and the dismissal should be reversed.

II. The Amended Complaint also alleges vicarious liability based on the joint-venture relationship between Defendants. The Court of Chancery rejected these allegations with little explanation, seemingly based on its holding that the existence of a joint venture is a legal question to be decided on the pleadings. However, this Court has held explicitly that joint venture is a question of fact, and accordingly courts rarely decide the issue on the pleadings. The Amended Complaint alleges facts establishing all elements of a joint venture—and, at a minimum, showing that each element is reasonably conceivable. In particular, there was a community of

interest between Defendants in auditing Citigroup, Banamex, and OSA; joint control based on policing one another's day-to-day conduct; and a joint proprietary interest and sharing of profits and losses based on KPMG agreements establishing rights to profit-sharing and duties to share losses. The Court of Chancery's conclusion that these allegations were not sufficiently particularized—because, *e.g.*, Plaintiffs did not specify precisely how profits and losses were divided (information solely within Defendants' control)—defies the proper analysis at the pleading stage. Indeed, as with agency, the allegations of joint venture far exceed those that are routinely accepted as sufficient to survive a motion to dismiss. Accordingly, the Court of Chancery's dismissal should be reversed on this independent ground.

III. The Court of Chancery further erred in holding that Plaintiffs failed to state a claim under Mexican law, and because it is premature to decide choice of law at the pleading stage, this error also requires reversal. The Court of Chancery's holding relies solely on the theory that Mexican law requires a written agreement for an agency or joint venture. However, the limited statutory provisions the Court of Chancery relies upon concern power of attorney, not other forms of agency, and joint liability, not joint ventures. Moreover, the Court of Chancery does not cite a single Mexican case supporting its written-agreement rule, and there are several cases refuting it. In short, the Court of Chancery's interpretation of Mexican law is in error.

STATEMENT OF FACTS

A. OSA's Fraudulent Cash-Advance Facility

The centerpiece of the massive fraud at issue was OSA's cash-advance facility at Citigroup/Banamex. OSA obtained *billions* of dollars in advances, supported by invoices purportedly reflecting as-yet-unpaid work OSA had performed for Pemex. A245. Before advancing any funds to OSA, Citigroup/Banamex was supposed to confirm OSA's creditworthiness and the authenticity of the Pemex invoices. A249. Citigroup/Banamex failed to do so, and Defendants failed to detect the internal control failures, as required by audit standards. A320-39; *see also* A3026-27 (SEC Order sanctioning Citigroup $4.75 million for "internal accounting control" failures related to the fraud).

The fraud began in 2008-2010, culminating in a frenzy of activity between September 2013 and February 2014, when Citigroup/Banamex disbursed at least 166 cash advances to OSA, totaling *$750 million*, based on fraudulent invoices. A301-02,3020-24. The underlying Pemex contracts totaled $542 million, meaning OSA received *over $200 million more* in advances than the contracts' value (even assuming OSA had actually performed the services). A302. By 2014, Citigroup/Banamex had increased OSA's cash-advance limits by approximately 500%, collecting tens of millions of dollars in interest annually in return. A250,303. This relationship Defendants audited on both sides was "interdependent … at every

level"; Citigroup/Banamex acted as OSA's banker and trustee, advised OSA on bond offerings, and funded its operations. A248-49.

On February 28, 2014, after Pemex informed Citigroup that certain OSA invoices were illegitimate, Citigroup disclosed the fraud and canceled the cash-advance facility. A307-08. OSA then collapsed. A246.

B. Defendants Conducted The Audits As An Integrated Organization

1. KPMG-US Controls KPMGI, Which Controls KPMGM

KPMG-US, a Delaware entity, is one of four founding members of KPMGI, conferring special status within the organization. A282,382,406. KPMG-US is by far the largest of KPMGI's 155 member firms, contributing nearly one-third of KPMG's global revenues in 2015. A382,403.

KPMGM routinely and publicly touts its membership and unity with KPMGI, emphasizing that "KPMG" operates as a "network of member firms" with a shared identity, defining what it stands for and how it operates. A397-98. As detailed below, KPMG-US has real-world control over KPMGI, and KPMGI in turn controls its smaller member firms, including KPMGM.

2. Defendants Jointly Contributed To The Engagements

KPMGI portrays itself and operates "as a single worldwide firm for companies that have global operations." A381,415-16. To attract international businesses like Citigroup and OSA, KPMGI markets itself and its member firms as a "unitary 'KPMG'" and touts the organization's unique strength to "serve clients

seamlessly and consistently across geographies." A384. For example, here KPMGM and KPMG Singapore coordinated multiple activities in the OSA engagement. A395.

Defendants jointly managed risks in the Citigroup/Banamex and OSA engagements, A413, and shared resources, A412-14, personnel, A384-85,398-99,413-15, and profits/losses, A388,412-13. Defendants also shared a stake in the reputation of KPMG's name, including in the audits here. A386-88,415-16. They further "police[d] one another's day-to-day conduct" through periodic reviews, A392,414, evaluating each other's compliance with KPMG policies and procedures, A287-88,392-94,407-09.

C. Defendants Failed To Identify Control Deficiencies And Detect And Prevent The Fraud

KPMGM and KPMG-US issued "clean" audit letters for OSA and Citigroup/Banamex for years and failed to expose the wrongdoing or identify the deficient controls that allowed it to occur. A252. KPMGM was OSA's auditor from 2010-14,[2] and Banamex's auditor since at least 2005, performing annual audits on a stand-alone basis and as a component auditor for KPMG-US's consolidated audits of Citigroup. A282,397. KPMG-US has been Citigroup's independent auditor since

[2] KPMGM did not issue an audit letter for 2013, but was auditing OSA when the fraud was revealed. A324.

at least 2010. A282. KPMG-US assumed responsibility for and was required to be involved in KPMGM's Banamex audit work. A286-88,290-91,407-09.

As the auditors of OSA and Citigroup/Banamex, KPMGM and KPMG-US were in the unique position—and were required by audit standards—to assess and review their clients' financial operations from multiple angles. A248-50,285-86. Instead, they turned a blind eye to, *inter alia*: (1) OSA's lack of effective controls; (2) its false cash-advance requests; (3) the faulty internal controls at Citigroup/Banamex that should have detected the false requests; (4) the fraud itself; and (5) the financial statements that were misstated because they failed to identify the above. A381.

KPMGM and KPMG-US made unequivocal, false representations that, *inter alia*, each audit was conducted in accordance with applicable standards, and the financial statements were fairly presented. A246,252,300,320-349. Their audits failed every one of the essential and required audit standards. A246,250-52,288,300-01,305,314-339.

While working on the 2013 audits of OSA and Citigroup/Banamex, KPMGM and KPMG-US should have determined that their clients' "internal controls over the revenues, accounts receivable and cash advances" were "materially deficient and effectively non-existent to prevent fraud." A338. Applicable auditing standards required KPMGM and KPMG-US to bring this to management's attention,

immediately "revisit and revise their earlier audits," and—if management failed to act appropriately—make their action publicly known, including by notifying third parties such as Plaintiffs. A338-39. Defendants did none of this. A339.

D. Defendants' Negligence Cost Plaintiffs Over $1.1 Billion

KPMGM's and KPMG-US's negligent audits caused Plaintiffs to lose over $1.1 billion. A339. But for the clean audit letters, Plaintiffs would not have invested, or continued to invest, in OSA. *E.g.*, A350. Instead, Plaintiffs would have rescinded or renegotiated transactions with, or reduced their exposure to, OSA. A427-28.

E. Opinions Below

In the Superior Court, Plaintiffs requested jurisdictional discovery relevant to KPMGI and KPMGM and were assigned a Special Master. Ex. B at 2-3. The Special Master found "that the joint venture/agency theory advanced by Plaintiffs [wa]s not 'clearly frivolous,'" though limited the scope of jurisdictional discovery based on Defendants' own statements that their work on the Banamex audits occurred outside of Delaware. Ex. C at 11, 24-27. The Superior Court adopted those findings based on an analysis of Delaware contacts, not the merits of vicarious liability, which the Special Master noted was a factual question. Ex. C at 13-14; Ex. D at 12. The Superior Court then ruled that it lacked subject-matter jurisdiction to hear negligent misrepresentation claims, nullifying its earlier rulings. A85.

Plaintiffs re-filed their complaint in the Court of Chancery. A86. On February 28, 2019, the Court of Chancery dismissed the claims against KPMGM and KPMGI for lack of personal jurisdiction and against KPMG-US on the merits. Ex. E. Plaintiffs amended their Complaint, focusing their allegations on KPMG-US's vicarious liability for the OSA audits based on KPMGM acting as sub-agent through KPMGI or based on a joint venture between Defendants. A244,423-28.

On August 21, 2020, the Court of Chancery dismissed Plaintiffs' claim against KPMG-US. Op. 22-37, 51-53. The court applied Delaware law because it analyzed Delaware, New York, and Mexican law and found that "no actual conflict of law exist[ed]." Op. 10. The court's analysis was "color[ed]" and "foreshadow[ed]" by the Special Master's and Superior Court's denial of jurisdictional discovery into Plaintiffs' supposedly "frivolous theories of vicarious liability," Op. 13 n.52, contradicting the rulings in the Superior Court, which in any event were made without subject-matter jurisdiction and regarding a since-superseded pleading, *supra* 11.

As to agency, the Court of Chancery held that Plaintiffs' sub-agency theory failed because Plaintiffs did not allege "that KPMG[-]US personnel used their positions to control KPMG[I] in relation to KPMG[M] or the OSA Audit Opinions," and that while "Plaintiffs allege that KPMG[I] may have the right to control

KPMG[M], [they] do not allege that KPMG[I] has yet to do so in any sense[.]" Op. 33. The court made similar findings under New York law. Op. 43-44.

As to joint venture, the court held that "Plaintiffs have failed to plead every element, from joint control to a right to share in the profits." Op. 52. In a single paragraph with little explanation, the court labeled Plaintiffs' joint-venture allegations "conclusory" and "inadequate." Op. 52. The court did the same under New York law. Op. 55.

Under Mexican law, for agency and joint venture, the court held that a written agreement establishing such a relationship was required and that Plaintiffs failed to allege a written agreement. Op. 21, 50-51.

ARGUMENT

As alleged in the Amended Complaint, KPMG-US is vicariously liable for the negligent audits of OSA because KPMGM was a sub-agent of KPMG-US and because they were in a joint venture together. The Court of Chancery did not dispute that the Amended Complaint adequately alleged all elements of a negligent misrepresentation claim based on the OSA audits, instead resting its dismissal as to KPMG-US solely on the supposed failure to plead agency or joint venture. However, the court's dismissal was based on legal errors in defining agency and joint venture and its refusal to accept well-pleaded factual allegations.

The Court of Chancery applied Delaware law because it found no actual conflict of law. Op. 10. Plaintiffs agree that there is no actual conflict, and that Delaware law should apply. Regardless, there are factual questions about the location of much of the conduct at issue, which precludes a decision now on the choice-of-law issue. *See Istituto Bancario Italiano SpA v. Hunter Eng'g Co.*, 449 A.2d 210, 226 n.23 (Del. 1982); *Dow Chem. Co. v. Organik Kimya Holding A.S.*, 2018 WL 2382802, *6 (Del. Ch. May 25, 2018); *Barrera v. Monsanto Co.*, 2016 WL 4938876, *11 (Del. Super. Sept. 13, 2016). Further, while the Court of Chancery analyzed New York law in the alternative, Op. 38-45, 53-56, its reasoning mirrored its Delaware law analysis and is erroneous for the same reasons.

I. The Court Of Chancery Erred In Holding That The Amended Complaint Did Not Sufficiently Allege KPMGM Was A Sub-Agent Of KPMG-US

A. Question Presented

Whether the Court of Chancery erred by dismissing the claim against KPMG-US based on the idea that agency requires exercise of control and is not sufficiently alleged despite factual allegations establishing KPMG-US has a right to control KPMGI and KPMGI has a right to control KPMGM.[3]

B. Scope Of Review

This Court "review[s] trial court rulings granting motions to dismiss *de novo*." *Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Holdings LLC*, 27 A.3d 531, 535 (Del. 2011).

C. Merits Of Argument

As alleged in the Amended Complaint, KPMG-US is vicariously liable for the negligent audits of OSA conducted by its sub-agent, KPMGM, which acted with KPMGI's authority, which in turn acted with KPMG-US's authority. A406-07. "Actual authority is that authority which a principal expressly or implicitly grants to an agent." *Billops v. Magness Constr. Co.*, 391 A.2d 196, 197 (Del. 1978). Thus, an agent's actual authority can be implied, and proven "on the basis of a principal's conduct other than written or spoken statements that explicitly authorize an action."

[3] Issue preserved below. A3116-22.

Restatement (Third) of Agency § 2.02 cmt.c. The principles of agency apply equally to related corporate entities. *See Chrysler Corp. v. Chaplake Holdings, Ltd.*, 822 A.2d 1024, 1035 (Del. 2003). As discussed below, the Amended Complaint provides extensive factual allegations establishing implied actual authority.

The "relationships between a subagent and the appointing agent and between the subagent and the appointing agent's principal are relationships of agency." Restatement (Third) of Agency § 3.15(1). The parties and Court of Chancery did not dispute that sub-agency is a legitimate agency relationship as a matter of law. The allegations here show that all elements of agency are satisfied.

1. The Court Of Chancery Erred As A Matter Of Law In Holding That Agency Requires Exercise Of Control Over, Rather Than A Right To Control, The Agent

The Court of Chancery's dismissal of the claim against KPMG-US is based on its misstatement of the legal test for agency as requiring the principal to exercise control over the agent, rather than simply have a right to control the agent. This Court has long recognized that an agency relationship exists where the principal "controls, *or has the right to control*," the agent. *Billops*, 391 A.2d at 197-98 (emphasis added). This distinction between exercise of control and right to control is critical: "The test being the right to control, it makes little difference whether or not that right has actually been exercised." *Lester C. Newton Trucking Co. v. Neal*, 204 A.2d 393, 395 (Del. 1964); *see also Melson v. Allman*, 244 A.2d 85, 87-88 (Del.

1968) ("[T]he word 'control' means the right to control, rather than the actual exercise of that right. … [A] master may not escape liability for acts of his servant simply by failing to exercise his right of control over the servant."). The Restatement also recognizes "right to control" as the correct test. *See* Restatement (Third) of Agency § 1.01 cmt.f(1). And this Court consistently follows the Restatement approach. *See Hecksher v. Fairwinds Baptist Church, Inc.*, 115 A.3d 1187, 1200-02 (Del. 2015).

While briefly mentioning the proper test as "right to control," Op. 24-25, however, the Court of Chancery held that there could be no agency relationship without actual *exercise* of control, regardless of the right to control. In particular, the court stated: "Plaintiffs allege that KPMG[I] *may have the right to control* KPMG[M], but do not allege that KPMG[I] has *yet to do so* in any sense[.]" Op. 33 (emphasis added). The rest of the court's reasoning likewise focuses on *exercise* of control over the "specific wrongful act," rather than *right* to control. Op. 31 ("Plaintiffs do not plead that KPMG[-]US wielded control over the OSA Audit Opinions as KPMG[M]'s principal."); Op. 33 ("[W]ithout further assertions that KPMG[-]US personnel used their positions to control KPMG[I] in relation to KPMG[M] or the OSA Audit Opinions, the allegations lack a crucial connection."); Op. 34 ("Plaintiffs allege no such similar execution of control over KPMG[M].").

The Court of Chancery's reasoning not only conflicts with the many precedents cited above, but also undermines basic principles of agency and vicarious liability. The premise of agency is that the agent has authority to make decisions of its own with the principal's authority but without the principal necessarily exercising control over those decisions. Indeed, principals are liable for the acts of their agents within the scope of their agency even if the principal was *unaware* of them. *Meyer v. Holley*, 537 U.S. 280, 285-86 (2003). In addition, if a corporation actually exercised control over the wrongful conduct, then it is *directly* liable for its participation. *Pearson v. Component Tech. Corp.*, 247 F.3d 471, 486-87 (3d Cir. 2001). Thus, making such exercise of control a requirement for *vicarious* liability would effectively nullify the agency doctrine.

2. Applying The Correct Test For Agency, The Allegations More Than Suffice To Render It Reasonably Conceivable That KPMGM Is A Sub-Agent Of KPMG-US

The Amended Complaint's allegations far exceed those required to show that sub-agency is reasonably conceivable (*i.e.*, that KPMG-US had a right to control KPMGI, which in turn had the right to control KPMGM). "[A] complaint will survive a motion to dismiss if it states a cognizable claim under any 'reasonably conceivable' set of circumstances inferable from the alleged facts." *Winshall v. Viacom Int'l, Inc.*, 76 A.3d 808, 813 n.12 (Del. 2013). The Court of Chancery's

dismissal here rested both on its erroneous legal test and its refusal to credit the factual allegations of the Amended Complaint.

To begin with, agency is a factual issue that is almost never decided on the pleadings. "The determination of whether an agency relationship exists is normally a question of fact," and accordingly the "determination is ordinarily made by the factfinder." *Fisher v. Townsends, Inc.*, 695 A.2d 53, 59, 61 (Del. 1997). This conclusion follows from the principle that "questions of agency are not subject to absolute rules but, rather, turn on the facts of the individual case." *Sussex Cty. v. Morris*, 610 A.2d 1354, 1360 (Del. 1992).

Courts are especially reluctant to require detailed support for agency at the pleading stage because the facts are almost invariably within the defendant's exclusive control. For instance, the Third Circuit held that the plaintiff "is not required to have extensive proof [of agency] at the complaint stage," and "discovery is necessary when an agency relationship is alleged." *Jurimex Kommerz Transit G.M.B.H. v. Case Corp.*, 65 F. App'x 803, 808 (3d Cir. 2003); *see also In re Craftmatic Sec. Litig. v. Kraftsow*, 890 F.2d 628, 645 (3d Cir. 1989) ("[P]laintiffs cannot be expected to have personal knowledge of the details of corporate internal affairs [at the pleading stage]."); *Kuhn Constr. Co. v. Ocean & Coastal Consultants, Inc.*, 844 F. Supp. 2d 519, 531 (D. Del. 2012) ("[A]n agency relationship is

determinable only after appropriate discovery and, thus, is not appropriate for a motion to dismiss.").

The Court of Chancery erroneously disregarded this principle. Instead, it cited one 42-year-old case for the theory that "'[t]he interest of judicial economy' is best served 'by [an immediate] decision on the question of agency relationship.'" Op. 23 (quoting *Japan Petroleum Co. v. Ashland Oil, Inc.*, 456 F. Supp. 831, 838 (D. Del. 1978)). However, *Japan Petroleum* applied a summary-judgment standard after discovery (which Plaintiffs here sought on a jurisdictional basis and were denied, Ex. D at 12), and regardless, this theory of the need for immediate resolution of agency has never been adopted by any Delaware state court (or any other court of which we are aware). Moreover, the three cases that the Court of Chancery cites (Op. 22-23 n.86) for the proposition that the issue can be resolved on a motion to dismiss actually illustrate just how rare such a dismissal should be. In all three, there were no allegations *at all* to establish that the principal had a right to control the supposed agent.[4]

[4] *See Skye Mineral Inv'rs, LLC v. DXS Capital Ltd.*, 2020 WL 881544, *23 (Del. Ch. Feb. 24, 2020) ("Plaintiffs have not well pled that … Defendants had any right to force [the alleged agent] to take the actions that allegedly comprise his breach of fiduciary duties."); *Baccellieri v. HDM Furniture Indus., Inc.*, 2013 WL 1088338, *3 (Del. Super. Feb. 28, 2013) ("Plaintiffs' Complaint … is devoid of any factual allegations to support [its agency] assertion."); *Albert v. Alex. Brown Mgmt. Servs., Inc.*, 2005 WL 2130607, *10 (Del. Ch. Aug. 26, 2005) ("There is simply no

Here, in contrast, there were not only explicit allegations of a right to control, but extensive factual allegations that make such a right to control far more than reasonably conceivable, especially for the OSA audits at issue.

a. The Amended Complaint Alleges That KPMGI Is An Agent of KPMG-US

The Amended Complaint alleges KPMGI acted with KPMG-US's actual authority based on KPMG-US's right of control over KPMGI. A406. In support, Plaintiffs allege numerous facts that make such control not only reasonably conceivable, but very likely.

First, Plaintiffs specifically allege that KPMG-US plays a dominant role in KPMGI's operations based on the positions of KPMG-US's high-level personnel within KPMGI. A403-05. KPMG-US "personnel make up 40% of KPMG[I]'s Global Management Team," "one of the prime governance entities of KPMG[I]." A404. KPMG-US's Chairman and CEO was also KPMGI's Global Chairman until 2015, and he continued to serve as KPMGI's Global Chairman from KPMG-US's New York office until 2017. A404. In addition, "at least the last two Global Heads of Audit for KPMG[I]," the most important position within the KPMG network, "held senior positions at KPMG[-]US before joining KPMG[I]." A404. The "outgoing Global Head of Audit returned to KPMG[-]US to serve as the Global Lead

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allegation in the complaints that [defendant] expressly gave [alleged agents] the authority to bind it[.]").

Partner for one of KPMG[-]US's largest industrial audit clients." A404. KPMG-US personnel also hold key positions as Global Head of Advisory, Global Chief Operating Officer, and Global Head of Quality, Risk and Regulatory. A405.

Second, there is strong reason to believe that KPMG-US's personnel have control given the size and importance of KPMG-US within KPMGI's global organization. KPMG-US is far and away KPMGI's largest member firm, accounting for nearly one-third of KPMGI's global fee income. A403. KPMG-US is also one of KPMGI's four founding members, with special status, including control over the rights to the KPMG name—the network's most valuable asset. A382,387,406.

Third, KPMG-US has a particularly strong position to control KPMGI's audit practices. KPMG-US liaises with KPMGI's Standards Group on international auditing standards matters; KPMG-US's Audit Quality and Process Monitor Group is responsible for conducting internal and external inspections of KPMG auditors; KPMG-US participates in remedial responses to problems; and KPMG-US's Inspections Group executes the annual internal inspection program. A405-06.

These three sets of allegations far exceed the minimal pleading standard for an agency relationship. Indeed, the Delaware district court consistently has rejected motions to dismiss based merely on a close connection between the alleged principal and agent, without more. *See British Telecommc'ns PLC v. IAC/InteractiveCorp*, 356 F. Supp. 3d 405, 410 (D. Del. 2019) (holding it sufficed that plaintiffs "present

a plausible factual scenario of close coordination and a joint strategy"); *T-Jat Sys. 2006 Ltd. v. Expedia, Inc.*, 2017 WL 896988, *6 (D. Del. Mar. 7, 2017) ("[T]he court can reasonably deduce Expedia-DE directed Expedia-WA's actions, and likewise … directed Orbitz's activities … based on the close connection between the respective companies."); *StrikeForce Techs., Inc. v. PhoneFactor, Inc.*, 2013 WL 6002850, *5 (D. Del. Nov. 13, 2013) ("These allegations suggest a close connection in the operations of the two companies, making it reasonable to infer [the parent] authorized or directed [its affiliate's] adoption of [a] service."). Such a close connection is plainly alleged here—as well as many additional facts strongly supporting an agency relationship.

Similarly, the Third Circuit has held that "[b]y including in its amended complaint the necessary occurrences and reasons that [the alleged principal] controlled its subsidiaries' actions, [the plaintiff] has alleged sufficient facts to survive a Rule 12(b)(6) motion." *Jurimex*, 65 F. App'x at 808. Plaintiffs here allege far more than just "necessary occurrences and reasons." Indeed, these federal cases applied a substantially *higher* pleading standard than Delaware's "reasonably conceivable" standard. *See Cambium Ltd. v. Trilantic Capital Partners III L.P.*, 2012 WL 172844, *1 (Del. Jan. 20, 2012). The Court of Chancery did not and could not conclude that Plaintiffs' allegations fail to meet the correct standard of reasonable conceivability.

Instead, the Court of Chancery's holding was based on a single sentence: "The last allegation [concerning the roles of KPMG-US personnel in KPMGI] comes closest to alleging that KPMG[-]US has general control over KPMG[I], but without further assertions that KPMG[-]US personnel used their positions to control KPMG[I] in relation to KPMG[M] or the OSA Audit Opinions, the allegations lack a crucial connection." Op. 33. However, this sentence betrays the improper focus on *exercise* of control, rather than *right* to control. While the Court of Chancery insists that control must be related to the OSA audits, and cites certain cases discussing that concept, *see* Op. 26-30, none of these cases refutes the point that there need only be a relationship between the *right* to control (not the *exercise* of control) and the wrongdoing—a standard plainly met by Plaintiffs' allegations. In short, the question is whether the principal had a right to control the allegedly wrongful conduct. *See, e.g.*, *Billops*, 391 A.2d at 197-98.

There is no reason to believe that the right to control here, which specifically concerns auditing, somehow did not apply to KPMGM's OSA audits. And there is certainly no reason to reject that reasonable inference on a motion to dismiss. Indeed, even in the context of a jury trial, this Court held that the jury could infer an agency relationship based on evidence that the principal was "on-board with" and had a "major influence," without direct influence that it controlled the action at issue.

Chrysler, 822 A.2d at 1035. The Court of Chancery's demand for direct influence at the pleading stage was therefore erroneous.

Moreover, not only is there a reasonable inference of the right to control the OSA audits from the general right to control auditing practices, but there are specific factual allegations making such control especially clear for those audits. As the Amended Complaint alleges, there was significant overlap between KPMGM's OSA and Banamex audits and KPMG-US's Citigroup/Banamex audits. A410-11. The Court of Chancery disregarded these allegations as "conclusory," Op. 32, but the existence of an overlap is not a conclusion; it is a fact. And it is more than reasonably conceivable given that (1) OSA, Banamex, and Citigroup had extensive business dealings; (2) KPMG-US and KPMGM were auditing both sides of the *very same credit-facility transactions that were the engines of the fraud*; (3) audit standards required KPMG-US to have direct control over KPMGM's Banamex component audits; (4) KPMG-US communicated directly with KPMGM regarding the Citigroup/Banamex audits; and (5) all of these audits were done subject to the same KPMGI audit procedures, manuals, software and quality-control processes. A288,301-03,318,386,408,410-11. Simply put, the underlying transactions in the audits were the same, and it is more than reasonably conceivable to infer that KPMG-US and KPMGM (which even audited OSA and Banamex out of the same office, A339-45) did not audit different sides of these transactions independently.

b. The Amended Complaint Alleges That KPMGM Is An Agent of KPMGI

Plaintiffs have likewise alleged KPMGI's control over KPMGM. A400. Plaintiffs specifically allege that KPMGI established policies and procedures governing KPMGM's audits, which necessarily would have applied to the OSA audits. A385-88,399-400. As a member firm, KPMGM had to enter into an agreement with KPMGI that requires, *inter alia*, compliance with KPMGI's policies and procedures, including use of KPMGI's audit methodology, software, and quality control policies. A386. Accordingly, KPMGI "control[s] the manner and method by which KPMG member firms [*e.g.*, KPMGM] carry out their work," and ensures compliance with its global policies and procedures by conducting regular and specially mandated firm reviews. A388,392-94,401-02 ("KPMG[M] … was required to … abide by KPMG[I]'s policies and procedures," including "audit procedures" while "auditing [OSA]"). KPMGI has the right to demand evidence of any member firm's compliance and to impose disciplinary measures, including disciplining individual local partners and expelling member firms. A386,393-94.

These allegations are more than sufficient to satisfy the "control" element under Delaware law. *See Billops*, 391 A.2d at 198 (denying summary judgment on agency where Hilton hotel franchisors incorporated operating manual, which set mandatory standards and procedures, into franchisee agreements); *Chrysler*, 822 A.2d at 1035 (affirming jury verdict of liability where principal had a "major

influence" over agent); *Hospitalists of Del., LLC v. Lutz*, 2012 WL 3679219, *16 (Del. Ch. Aug. 28, 2012) (denying motion to dismiss based on allegations of overlapping high-level personnel and day-to-day control over the agent); *Jack J. Morris Assocs. v. Mispillion St. Partners, LLC*, 2008 WL 3906755, *3 (Del. Aug. 26, 2008) (denying summary judgment where agent claimed he "reasonably believed" he had authority to act and acted with defendant's knowledge); *Wilson v. Active Crane Rentals, Inc.*, 2004 WL 1732275, *2 (Del. Super. July 8, 2004) (denying summary judgment in light of ongoing business relationship between purported principal and agent).[5]

In addition, the Amended Complaint specifies KPMGI's extensive exercise of control over KPMG South Africa ("KPMG-SA") as a paradigmatic example. A389-92. The Court of Chancery recognized that there were "detailed allegations of KPMG[I] wielding control over [KPMG-SA]," Op. 15—which included firing or replacing several employees, and appointing KPMGI's own COO as KPMG-SA's

[5] The Court of Chancery ignores *Billops* and *Chrysler*, and its attempt to distinguish the other three cases fails to confront the facts alleged here. In one case, the Court of Chancery notes (Op. 30) allegations of "day-to-day control," *Hospitalists*, 2012 WL 3679219, *16, which is extensively alleged here, as discussed in the text. *See also* A414 ("KPMG[I] member firms also police one another's day-to-day conduct."). In the other two cases, the Court of Chancery noted (Op. 36) evidence that the alleged agent could act on the principal's behalf (*see Mispillion*, 2008 WL 3906755, *3; *Wilson*, 2004 WL 1732275, *2), but again that is also alleged here, *see* A401, and lack of evidentiary proof is irrelevant because discovery has not yet occurred (unlike in *Mispillion* and *Wilson*, which were on summary judgment).

Interim COO following a scandal based on failed audits, A389—but held this did not suffice because "[t]he Amended Complaint does not allege a similar exercise of control over KPMG[M]," Op. 8. However, the Court of Chancery missed the point: KPMGI's *exercise* of control over KPMG-SA showed its *right* to control all member firms, including KPMGM. There is no reason to believe that KPMGM was somehow exempt from the same right to control that KPMGI exercised over KPMG-SA following revelations of shoddy audit work—and, at a minimum, this is a reasonable inference that must be accepted at the pleading stage. Indeed, it would be anomalous (and deeply ironic) that an entity can face vicarious liability only by disciplining a member firm (as KPMGI did for KPMG-SA, A389-92) but evade liability simply by refusing to impose such discipline, keeping such discipline confidential, or delaying it until after any litigation risk has been eliminated.

More generally, the Court of Chancery's analysis rested on its erroneous requirement of an exercise of control. *See* Op. 33. The court conceded that "Plaintiffs allege that KPMG[I] may have the right to control KPMG[M]." *Id.* To the extent the court disputed the connection between control and the OSA audits, *see id.* 33-34, the refusal to credit the factual allegations of such a connection is erroneous for the reasons already stated, *supra* 25. In short, the Court of Chancery's mandate that a plaintiff must allege exercise of control, and do so with particularity before discovery, would make pleading agency virtually impossible and wrongfully

allow principals to act with impunity so long as they do not publicly disclose their control over wrongful conduct.

3. Other Cases Examining Agency Relationships Among Audit Firms Confirm The Sufficiency Of The Allegations Here

Courts that have examined similar allegations in the audit context have recognized that they suffice to allege agency. For example, in *Parmalat*, the district court found a potential agency relationship between Grant Thornton International ("GTI"), similar to KPMGI, and its member firm and Parmalat auditor, Grant Thornton S.p.A. ("GT-Italy"), similar to KPMGM, with that sub-agency relationship extending to Grant Thornton LLP ("GT-US") as the lead principal, similar to KPMG-US. 598 F. Supp. 2d 569 (S.D.N.Y. 2009). The court held that GT-Italy could be GTI's agent because plaintiffs alleged facts indicating that GTI had control "over 'the manner and method' by which its member firms, including GT[-]Italy, performed their work," *e.g.*, member agreements requiring compliance with GTI policies, including auditing procedures and software. *Id.* at 573-74. Plaintiffs here have alleged KPMGI's similar control over the manner and method of KPMGM's audits. A386-88,400-01.

Moreover, the facts supporting GT-US's liability as principal of GTI are virtually identical to those here:

GT-US (598 F. Supp. 2d at 578-80)	**KPMG-US**
GT-US held two seats on the 12-member GTI Board, with veto power over certain decisions.	KPMG-US personnel make up 40% of KPMGI's Global Management Team. A404.
GT-US was largest funder of GTI.	KPMG-US accounted for nearly one-third of KPMGI's income. A403.
GTI's director of audit and quality control and chair of GTI's IT committee were GT-US partners.	Last two KPMGI Global Heads of Audit held senior positions at KPMG-US. A404. KPMG-US personnel are also Global Head of Advisory and Global Head of Quality, Risk and Regulatory. A405.
GTI's CEO has always been a partner of GT-US or GT-UK.	KPMG-US's Chairman and CEO was KPMGI's Global Chairman until 2015. He served as KPMGI's Global Chairman until 2017, based in KPMG-US's New York office. A404.
GT-US controlled significant GTI decisions through its Executive Partners Group.	(1) KPMG-US liaises with KPMGI's Standards Group on international auditing matters; (2) KPMG-US's Audit Quality and Process Monitor Group is responsible for conducting internal and external inspections of KPMG auditors; (3) KPMG-US participates in remedial responses to problems; and (4) KPMG-US's Inspections Group executes the annual internal inspection program. A405-06.

The Court of Chancery's attempt (Op. 40-41) to distinguish *Parmalat* is unavailing. The earlier *Parmalat* opinion it cites, 375 F. Supp. 2d 278, 290 (S.D.N.Y. 2005), is inapposite because it was a prior ruling in a federal securities

action that ignores the subsequent holding in one of the consolidated state law cases (asserting, *inter alia*, claims for misrepresentation) that liability *could* exist based on a sub-agency theory similar to the one asserted here. 598 F. Supp. 2d at 573. As to the relevant *Parmalat* ruling, the Court of Chancery attempts to distinguish it on the basis that GTI dictated step-by-step instructions for auditors and "the plaintiffs presented evidence that GTI expressly intervened in the very audit at issue." Op. 42. However, the Amended Complaint alleges similarly extensive control over KPMGI members' audit methodology. *Supra* 26, 29. And the "intervention" in *Parmalat* was threatening to expel and/or suspending member-firm personnel, which KPMGI unquestionably has a right to do (and did in a parallel situation at KPMG-SA, *supra* 27-28). A386,393-94.

Indeed, KPMG-US's connection to the specific audits here is far *greater* than GT-US's connection in *Parmalat* given that KPMG-US itself participated in auditing the other side of the same fraudulent transactions, *supra* 25, while GT-US had no such role in *Parmalat*. At a minimum, these sub-agency allegations suffice on a motion to dismiss, given that they satisfied the much higher bar of summary judgment in *Parmalat*. *See also Cromer Fin. Ltd. v. Berger*, 245 F. Supp. 2d 552, 560-61 (S.D.N.Y. 2003) (denying summary judgment on claim that Deloitte-International was vicariously liable for Deloitte-Bermuda conduct).

Finally, the Court of Chancery cites two cases supposedly to the contrary. Op. 38-39. But the first evaluated theories of *apparent agency* (*i.e.*, "holding out" liability) based on plaintiffs' perception of agency rather than the *actual authority* alleged here, and concerned solely allegations that member firms were a "unitary" or "combined" organization, *e.g.*, based on marketing materials, as opposed to far more comprehensive allegations here based on KPMGI's internal governance documents (*e.g.*, A386-88). *Star Energy Corp. v. RSM Top-Audit*, 2008 WL 5110919, *3 (S.D.N.Y. Nov. 26, 2008). The second rested on the theory that actual control is required and "*the right to* control" does not suffice, which (as discussed *supra* 16-18) clearly conflicts with Delaware law. *Anwar v. Fairfield Greenwich Ltd.*, 728 F. Supp. 2d 372, 459 (S.D.N.Y. 2010).[6] In any event, what were supposedly missing in *Anwar*—allegations suggesting a connection to the audits at issue—are present here. *Supra* 25. Neither *Anwar* nor any other case suggests such allegations can be rejected at the pleading stage.

[6] *Anwar*'s rejection of a "right to control" test is also an outlier that is inconsistent with established New York law, *see Khodeir v. Sayyed*, 348 F. Supp. 3d 330, 345 (S.D.N.Y. 2018), which follows the Restatement, *see Doe v. Guthrie Clinic, Ltd.*, 22 N.Y.3d 480, 487 (2014).

II. The Court Of Chancery Erred By Holding That The Amended Complaint Did Not Sufficiently Allege That Defendants Were In A Joint Venture

A. Question Presented

Whether the Court of Chancery erred by holding that the existence of a joint venture is a question of law and by dismissing the claims against KPMG-US on the theory that the allegations were not sufficiently specific in alleging the elements of a joint venture.[7]

B. Scope Of Review

This Court's review is *de novo*. *Supra* 15.

C. Merits Of Argument

In Delaware, members of a joint venture are vicariously liable for the conduct of co-venturers within the scope of the enterprise. *Hannigan v. Italo Petrol. Corp. of Am.*, 77 A.2d 209, 216 (Del. 1949); *Talley Bros., Inc. v. Ford Motor Co.*, 1992 WL 240341, *3 (Del. Super. Sept. 16, 1992). Plaintiffs sufficiently alleged the existence of a joint venture between Defendants in connection with the negligent OSA audits.[8]

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[7] Issue preserved below. A3125-29.

[8] Plaintiffs' allegations of agency are consistent with their allegations of joint venture because joint venturers can act as both principals and agents for one another. *See, e.g.*, *Hannigan*, 77 A.2d at 216. Even assuming *arguendo* there were any conflict between the agency and joint venture allegations, Plaintiffs are entitled to plead alternative liability theories. *See* Ct. Ch. R. 8(e)(2).

1. The Court Of Chancery Erred In Holding That The Existence Of A Joint Venture Is An Issue Of Law, Rather Than An Issue Of Fact

The existence of a joint venture is an issue of fact, and thus (as with agency) is rarely decided on a motion to dismiss. This Court has held explicitly that joint venture is a factual issue. *Warren v. Goldinger Bros., Inc.*, 414 A.2d 507, 508 (Del. 1980) ("The question presented … as to the parties' relationship was predominantly a factual one of applying the facts as found to criteria defining the differing legal relationships of … joint venture."); *id.* at 509 (reviewing finding of joint venture after trial for substantial evidence); *In re Coffee Assocs., Inc.*, 1993 WL 512505, *5 (Del. Ch. Dec. 3, 1993) (existence of joint venture "is essentially a factual determination"); Ex. C at 13-14 (Special Master recognizing that "whether the parties in fact formed a joint venture is a factual question"). This necessarily follows from the fact that a joint venture "may be implied or proven by facts and circumstances showing that such an enterprise was in fact entered into." *J. Leo Johnson, Inc. v. Carmer*, 156 A.2d 499, 502 (Del. 1959).

The Court of Chancery therefore erred by beginning its analysis with the premise that "[t]he existence of a joint venture may be determined on a motion to dismiss; it is not a precluded question of fact." Op. 52. The lone case cited by the court says nothing to dispute that the existence of a joint venture is an issue of fact, and it dismissed on the pleadings only because the limited partnership agreement (to

which the plaintiffs were parties) gave one entity "*exclusive* authority to manage" the entity at issue. *Wenske v. Blue Bell Creameries, Inc.*, 2018 WL 5994971, *8 (Del. Ch. Nov. 13, 2018). Absent this unusual circumstance, plainly inapposite here, courts generally do not decide the existence of a joint venture—a factual issue where defendants control the evidence—on the pleadings. *See Providence Creek Acad. Charter Sch., Inc. v. St. Joseph's at Providence Creek*, 2005 WL 2266490, *1-2 (Del. Ch. Sept. 9, 2005) (holding that plaintiff, "[w]ith the benefit of the 'plaintiff-friendly' motion to dismiss standard," sufficiently alleged joint venture where parties "cooperated … in furtherance of a common goal"; "worked together to provide … services"; and "shared leadership," despite agreement expressly disclaiming joint venture); *In re Carlisle Etcetera LLC*, 114 A.3d 592, 606-07 (Del. Ch. 2015).

2. The Allegations More Than Suffice To Render It Reasonably Conceivable That Defendants Are Part Of A Joint Venture

A joint venture "has been broadly defined as an enterprise undertaken by several persons jointly to carry out a single business enterprise … for their mutual benefit, in which they combine their property, money, effects, skill and knowledge." *Warren*, 414 A.2d at 508-09. Delaware does not require evidence of an explicit statement, oral or written, to form a joint venture, and will imply the existence of a joint venture based on a factual determination of the parties' intent or purpose. *Carmer*, 156 A.2d at 502. To demonstrate a joint venture, there must be "(1) a

community of interest in the performance of a common purpose; (2) joint control or right of control; (3) a joint proprietary interest in the subject matter; (4) a right to share in the profits; and (5) a duty to share in the losses." *Warren*, 414 A.2d at 509. Plaintiffs have sufficiently alleged each of these elements.[9]

The Court of Chancery's conclusion to the contrary was based on one paragraph where it asserted, without performing an element-by-element analysis, that none of the elements were satisfied. Op. 52-53. And the one case the court cites concerned the inapposite situation where the parties "were simply in negotiations over how and whether to form … an agreement." *Sunrise Ventures, LLC v. Rehoboth Canal Ventures, LLC*, 2010 WL 975581, *2 (Del. Ch. Mar. 4, 2010). The court's perfunctory approach appears to stem from its erroneous refusal to treat the existence of a joint venture as a factual issue. Rather than crediting the allegations, the court simply labeled them "conclusory." Op. 52. But using the word "conclusory" does not allow a court to reject allegations of fact that are reasonably conceivable, and the allegations here far exceed that standard. *See Precision Air, Inc. v. Standard Chlorine of Del., Inc.*, 654 A.2d 403, 406 (Del. 1995) ("An allegation, though vague

[9] The elements of joint venture in New York are substantially the same. Op. 53. To the extent the Court of Chancery concluded as a matter of New York law that Plaintiffs failed to allege intent to form a joint venture or that the joint venture provided services for the OSA audits, *see* Op. 55, that is simply incorrect. A386-88,410-16.

or lacking in detail, is nevertheless 'well-pleaded' if it puts the opposing party on notice of the claim being brought against it.").

a. Defendants Share A Community Of Interest In Providing Professional Services To Citigroup, Banamex, And OSA

As to the first element, Plaintiffs specifically allege a shared interest and common purpose in providing professional services to Citigroup, Banamex, and OSA. In particular, Defendants portray themselves and operate "as a single worldwide firm" (A381), and KPMGM "routinely and publicly touts its membership, and global unity with, [KPMGI]" (A397) and "emphasizes that KPMG operates as an international network of member firms offering audit, tax and advisory services" (A397). Moreover, Defendants shared resources, funds, and personnel to provide professional services to Citigroup, Banamex, and OSA. A394-95. Given that Defendants all shared an interest in the quality and reputation of the audits at issue here, the allegations are more than sufficient to show a common interest and purpose. *See Wah Chang Smelting & Ref. Co. of Am., Inc. v. Cleveland Tungsten Inc.*, 1996 WL 487941, *7 (Del. Ch. Aug. 19, 1996) (joint venture where parties contributed resources to pursue business); *Haley v. Talcott*, 864 A.2d 86, 95 (Del. Ch. 2004).

b. Defendants Jointly Controlled The Activities Of The Venture

Plaintiffs have demonstrated the second element—joint control or right of control—for the reasons stated *supra* 21-28. Moreover, even assuming *arguendo* that right to control were not sufficiently alleged, joint control is adequately alleged. Joint control does not require specific control of one entity over the other, but is satisfied by the parties controlling the action together. *See, e.g.*, *Pike v. Commodore Motel Corp.*, 1985 WL 11564, *3 (Del. Ch. May 10, 1985) ("While equality of control is often an element of a joint venture[,] the concept is a flexible one permitting the parties to allocate proportionate control[.]"). Such joint control is more than reasonably conceivable here given that Defendants "police[d] one another's day-to-day conduct" through periodic reviews and evaluated each other's compliance with KPMGI policies and procedures. A414; *see Wah Chang*, 1996 WL 487941, *4 (joint control where member operated companies day-to-day, but needed approval for major decisions). Indeed, that is especially clear for the OSA audits given they had to align with the Citigroup/Banamex audits, because they encompassed the very same set of credit-facility transactions. *Supra* 25. There could be no such alignment without joint control, and at a minimum that is a reasonable inference that must be accepted on a motion to dismiss.

c. Defendants Each Have A Proprietary Interest In The Enterprise And Right To Share In The Profits

Plaintiffs have also satisfied the third and fourth elements—a joint proprietary interest in the enterprise and a right to share in the profits—by alleging that Defendants each contributed to and had a financial stake in the engagements with OSA, Banamex, and Citigroup. Specifically, Defendants contributed funds and personnel to these engagements, shared in the profits flowing therefrom, and shared in the reputational stakes in such audits performed under the "KPMG" name, with "reputational capital" deemed to be KPMG's "most valuable asset." A387,412-15. The right to share profits arises from both KPMGI's governing agreements and its regular practices. A412. These allegations satisfy the third and fourth elements. *See In re McKinney-Ringham Corp.*, 1998 WL 118035, *3 (Del. Ch. Feb. 27, 1998) (Delaware corporation deemed joint venture where shareholders shared, *inter alia*, joint proprietary interest in corporation's subject matter and right to any profits); *Wah Chang*, 1996 WL 487941, *4; *Debakey Corp. v. Raytheon Serv. Co.*, 2000 WL 1273317, *5 (Del. Ch. Aug. 25, 2000).

The Court of Chancery erred in holding that Plaintiffs were required to plead specific details of the "profit … sharing structure between the entities" beyond the parties' governing agreements. Op. 52. Such a requirement of particularized allegations goes far beyond the usual pleading standard of reasonably-conceivable allegations that put the defendant on notice of the claim. *See, e.g.*, *Cent. Mortg.*, 27

A.3d at 538 (bare allegation that plaintiff had provided notice under a contract sufficed at pleading stage because, if proven, it "would entitle [plaintiff] to relief under a reasonably conceivable set of circumstances"). Moreover, the parties' governing agreements are a very reasonable source of an inference of profit-sharing. *See Hudson v. A.C.&S. Co.*, 535 A.2d 1361, 1364 (Del. Super. 1987) (implying profit-sharing where co-venturers agreed to divide product manufactured from joint-venture plant and each co-venturer contributed resources by sharing expenses). In any event, the allegations of profit-sharing here are specific, stating that Defendants shared profits through, *inter alia*, "profit transfers based on allocation percentages" and the "payment of referral fees and service charges between and among [Defendants]." A412-13. The Court of Chancery simply ignored this allegation, which cannot be discredited on a motion to dismiss.

d. Defendants Agreed To Share In The Losses Of The Enterprise

Plaintiffs have alleged the last element of a joint venture, the duty to share in losses under KPMGI agreements and practices. Specifically, the Amended Complaint alleges that Defendants "share the risk of losses flowing from their global engagements and fee commitments, including Citigroup, Banamex and Oceanografía" and (upon information and belief) "these losses are sometimes shared in proportionate amounts, but other times in amounts that are set so as to allocate greater revenue or losses to particular KPMG[I] member firms based on the

circumstances." A412-13. In addition, KPMGI requires participation in its insurance and indemnity program to manage risks, which necessarily includes losses. A388. And KPMGI statutes require member firms to jointly manage risks, which also includes losses. A413-14. These allegations more than suffice to show shared risk of loss. *See Carmer*, 156 A.2d at 503 (duty to share losses where each co-venturer was "liable in the operation of the enterprise to sustain a substantial loss in the event that the enterprise should not be successful"); *Decker, Decker & Assocs., Inc. v. Ass'n of Nat'l Advertisers, Inc.*, 2007 WL 1053881, *6 (N.Y. Sup. Apr. 10, 2007).

Moreover, this Court has not limited losses for purposes of the joint-venture analysis to "monetary losses," but also extends the analysis to losses incurred as a result of the "expenditure of time or out of pocket expense, or both," or to losses if "the enterprise should not be successful." *Carmer*, 156 A.2d at 502-03. By agreeing to share resources, as Defendants have, they necessarily agreed to share out-of-pocket expenses and losses for the enterprise. Indeed, these allegations far exceed those routinely accepted at the pleading stage. *See Mawere v. Landau*, 2013 WL 2217757, *6 (N.Y. Sup. May 15, 2013) (alleging only that parties agreed to jointly purchase and operate facilities together without alleging agreement to share losses); *Iocono v. Air Prods.*, 1993 WL 318857, *3 (Del. Super. July 24, 1985) (duty to share

losses where parties expressly agreed to share expenses, despite no written agreement to share losses).

The sharing of risks is especially clear here because any problems with the OSA audits would necessarily affect the Citigroup/Banamex audits, given that the very same underlying credit-facility transactions, and the internal controls that were supposed to prevent fraud in connection therewith, were at issue in all these audits. As discussed *supra* 25, the Court of Chancery's refusal to credit the factual allegations of the overlap in the audits was erroneous. And, as with the sharing of profits, the court erred in requiring particularized allegations of the loss-sharing structure. Op. 52.

III. The Court Of Chancery Erred By Holding That The Amended Complaint Did Not Sufficiently Allege A Claim Under Mexican Law

A. Question Presented

Whether the Court of Chancery erred by holding under Mexican law that vicarious liability based on agency or joint venture requires a written agreement.[10]

B. Scope Of Review

This Court's review is *de novo*. *Supra* 15.

C. Merits Of Argument

The Court of Chancery erred in dismissing the claim against KPMG-US under Mexican law, and thus should be reversed on this independent ground. "[T]he party seeking the application of foreign law has the burden not only of raising the issue of the applicability of foreign law, but also, of establishing the substance of the foreign law to be applied." *Germaninvestments AG v. Allomet Corp.*, 225 A.3d 316, 333 (Del. 2020). KPMG-US was the proponent of foreign law and did not meet its burden to show that Mexican law requires a written agreement for agency or joint venture, failing to cite a single case in Mexico ever adopting such a rule—an omission particularly telling in the face of the authorities and extensive analysis provided by Plaintiffs' expert.

[10] Issue preserved below. A3095-96,3125.

1. The Court Of Chancery Erred In Holding That Agency Requires A Written Agreement Under Mexican Law

Under Mexican law, an agency relationship does not require a written agreement. The Court of Chancery's conclusion to the contrary rested entirely on Article 2546 of the Mexican Federal Civil Code, Op. 18, but as Plaintiffs' expert explained, that law concerns only the relationship of a power of attorney, A3198-99. Indeed, the court recognized the limitation of Article 2546 to a power of attorney, but held: "In Mexico, power of attorney is a far more generalized agency relationship[.]" Op. 18. However, the *only* citations for this proposition, Op. 18 n.76, are a U.S. case and law review article, neither of which suggests that a power of attorney is the sole basis for agency or that an agency relationship outside the power-of-attorney context requires a written agreement.

The only Mexican case law on point cited by either party establishes that an agency relationship does not require a written agreement. A3200-01,3356-58. The Court of Chancery attempts to distinguish those cases on the facts, Op. 20-21, but any factual differences are irrelevant to the point that the Court of Chancery's absolutist view of agency as requiring a written agreement is erroneous. Indeed, the court's view would mean that one entity can evade liability entirely simply by directing another entity to act on its behalf without a written agreement. Such an extreme position would require some indication that Mexico intends such a rule, and there is none. At a minimum, the questions concerning the substance of Mexican

law and the factual questions regarding exactly what form the authorization of agency took here (*i.e.*, written, verbal, conduct, or some combination thereof) preclude dismissal at the pleading stage, particularly where the Court of Chancery disregarded that Plaintiffs alleged the existence of written member agreements between Defendants (which are uniquely within Defendants' control). A387.

2. The Court Of Chancery Erred In Holding That A Joint Venture Requires A Written Agreement Under Mexican Law

The Court of Chancery likewise erred in its analysis of joint venture by relying entirely on an inapposite statutory provision. Specifically, the court rested on Article 1988, which says nothing about joint ventures, but states only that certain types of joint liability require a written agreement or law establishing such liability. Op. 47. Plaintiffs' expert identified the law establishing liability here: Article 1917, which states that "all parties that cause a common injury are jointly liable for the damages caused to the victim." A3194-95,3413. The Court of Chancery provided no rationale to dispute that the plain language of Article 1917 applies here, instead simply distinguishing on the facts a case applying Article 1917. Op. 50. But again, the factual differences are inapposite, because the case, the text of Article 1917, and a case cited by Plaintiffs' expert that the court failed to address establish that Article 1917 provides a basis for joint liability independent of Article 1988. A3194-97,3201-03,3427,3437-38.

Furthermore, there is nothing in Mexican law requiring that a joint venture be in writing or disputing that a joint venture (in writing or not) creates joint liability under Article 1917. A3196. Once again, the Court of Chancery cites only an inapposite law review article, which makes no mention of Article 1988 or Article 1917. Op. 48 n.182. Accordingly, the court erred in holding that Mexican law absolutely requires a written agreement for a joint venture, let alone that KPMG-US met its burden to prove this as the proponent of foreign law. In any event, the question under Article 1917 is whether Defendants caused harm together, not whether there is a written joint-venture agreement among them. And the Amended Complaint more than suffices to allege such jointly-caused harm. A411-12,427.

CONCLUSION

For the reasons above, this Court should reverse the dismissal of the Amended Complaint and remand for further proceedings.

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