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IN THE SUPREME COURT OF THE STATE OF DELAWARE

OTTO CANDIES, LLC, et al. Plaintiffs Below-Appellants, v. KPMG LLP, Defendant Below-Appellee.	No. 338, 220 CASES BELOW: COURT OF CHANCERY OF THE STATE OF DELAWARE C.A. No. 2018-0435-MTZ SUPERIOR COURT OF THE STATE OF DELAWARE C.A. No. N16C-02-260-PRW (CCLD)

APPELLEE'S ANSWERING BRIEF

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Dated: January 15, 2021

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I. NATURE OF PROCEEDINGS

Plaintiffs are a large and diverse group of creditors and bondholders of Oceanografia S.A. de C.V. ("OSA"), a bankrupt Mexican company. Plaintiffs allege that OSA employees defrauded Banco Nacional de Mexico, S.A. ("Banamex") by creating false invoices for services that OSA had not provided and then inducing Banamex to extend loans to OSA based on the falsified invoices. After the fraud was revealed in February 2014, OSA declared bankruptcy. Plaintiffs seek to recover money that OSA allegedly owes them from KPMG LLP ("KPMG-US"), an American accounting firm that did not audit OSA and had no interaction with Plaintiffs.

KPMG-US is a Delaware limited liability partnership that is licensed to perform audits only in the United States and its territories. A282. It is a member firm of KPMG-International, which was a Swiss entity at all relevant times. *Id.* Member firms of KPMG-International are independent and legally separate entities. B730. KPMG-International is not an accounting firm and provides no audit or other professional services to clients. *Id.* The OSA audits at issue on this appeal were performed solely by KPMG Cardenas Dosal, S.C. ("KPMG-Mexico"), an independent member firm. A282. Plaintiffs assert that KPMG-US is vicariously liable for the OSA audits because it has influence over KPMG-International, which in turn has influence over KPMG-Mexico. This is contrary to the law of Delaware,

New York, and every other jurisdiction to consider this issue.

Plaintiffs have abandoned all but one of their claims. They originally sought to hold KPMG-US directly liable for its audit of the 2010-12 financial statements of Citigroup, Inc. ("Citigroup"), the parent of Banamex. Plaintiffs also originally sought to hold KPMG-US vicariously liable for KPMG-Mexico's audits of Banamex's 2010-12 financial statements. The Court of Chancery dismissed these claims and Plaintiffs have abandoned them. *See* Appellants' Opening Brief ("App. Br."), Ex. F (hereinafter "Mem. Op.") 56; App. Br. 2 (noting that these counts are "not at issue in this appeal"). Finally, Plaintiffs abandoned their claims against KPMG-Mexico and KPMG International Cooperative ("KPMG-International"), which the Court of Chancery dismissed for lack of personal jurisdiction. *See* App. Br. 2 n.1.

Plaintiffs appeal only the dismissal of their claim that KPMG-US is vicariously liable for alleged negligent misrepresentations by KPMG-Mexico in the OSA audit opinions. Plaintiffs offer two theories of vicarious liability, both deficient: (1) that KPMG-Mexico acted as a "sub-agent" of KPMG-US, through KPMG-International; and (2) that KPMG-US, KPMG-International, and KPMG-Mexico acted as a joint venture. This claim for negligent misrepresentation has been dismissed *three* times.

First, the Superior Court, where Plaintiffs initially filed their claims,

dismissed for lack of subject matter jurisdiction on April 25, 2018. A73-85.

Second, after Plaintiffs refiled their complaint in the Court of Chancery, on February 28, 2019, the Court dismissed Plaintiffs' claims against KPMG-US on grounds that precluded primary (and thus vicarious) liability: (1) under Delaware law, Plaintiffs failed to plead both (a) that KPMG-US or KPMG-Mexico owed them a duty as required to establish liability to a non-audit client, *and* (b) that Plaintiffs justifiably relied on the OSA audit opinions; (2) under New York law, Plaintiffs failed to meet the even higher standard for liability to non-clients; and (3) under Mexican law, the audit opinions were "far too distant" to be the "direct and immediate" cause of any harm Plaintiffs suffered. App. Br., Ex. E. 41-71.

Third, after Plaintiffs filed an Amended Complaint in 2019, on August 21, 2020, the Court of Chancery granted KPMG-US's motion to dismiss the remaining claim regarding KPMG-Mexico's OSA audits, holding that Plaintiffs failed to plead vicarious liability through any theory of agency or joint venture. Mem. Op. 13-56. The Court of Chancery noted that KPMG-US's motion to dismiss also "str[uck] at each element" required to plead negligent misrepresentation, but the Court "d[id] not reach those arguments" because the failure to plead vicarious liability was dispositive.[1] *Id.* at 9.

[1] Plaintiffs mischaracterize this statement, incorrectly asserting the Court "did not dispute that the Amended Complaint adequately alleged all elements of a negligent misrepresentation claim based on the OSA audits." App. Br. 14.

II. SUMMARY OF ARGUMENT

I. Denied. Plaintiffs ask the Court to become the first court in Delaware to hold that an accounting firm is vicariously liable for the conduct of a different member firm in the same global network, adopting an approach to principal-agent liability that is inconsistent with Delaware and New York law and far more expansive than principal-agent liability in any other state. In particular, Plaintiffs seek to overturn the fundamental principle that pleading agency liability requires factual allegations showing that the purported principal controlled the specific wrongful conduct at issue—here, the OSA audit opinions. Plaintiffs argue instead that merely alleging generic influence not tied to the wrongful conduct at issue is sufficient to establish agency liability for all conduct by the purported agent. The implication of Plaintiffs' legal theory would be that KPMG-US would face potential liability *for all audit work performed by every KPMG member firm around the world*. That is not the law, nor should it be.

Plaintiffs also raise a new distinction between "right of control" and "exercise of control"—which was neither litigated nor a premise of the decision below. Plaintiffs wrongly suggest that "exercise of control" is superfluous and irrelevant, even though Delaware and New York courts have looked for such allegations in agency cases. This newly-raised issue is a red herring; as the Court of Chancery held, the dispositive point is that the Amended Complaint does not

include a single factual allegation from which one might reasonably infer that KPMG-US or KPMG-International exercised control over—or had a right to control—the OSA Audits performed by KPMG-Mexico.

II. Denied. Plaintiffs ask this Court to be the first court in the United States to hold that separate and independent legal entities in a global network are a joint venture, vicariously liable for each other's conduct. Under Delaware and New York law, the Amended Complaint fails to allege all required elements for pleading a joint venture. Among other defects, the Amended Complaint does not plead that KPMG-US or KPMG-International participated in or controlled the OSA Audits in any way.

III. Denied. Under Mexican law, agency or "joint venture" relationships can be created only by a written agreement that *expressly states* an intention to create such a relationship—which is not the case here. The parties' Mexican law experts agree that Mexico is a civil law jurisdiction, where the law is based on statutes rather than cases. The statutes requiring written agreements for vicarious liability are thus dispositive.

III. STATEMENT OF FACTS

A. Plaintiffs Are Creditors of OSA, a Mexican Company that KPMG-US Did Not Audit.

OSA was a privately-held oil and gas services company in Mexico. A248. Its largest client was Petroleos Mexicanos ("Pemex"), Mexico's state-owned oil and gas company. A248, 285. OSA was beset by financial infirmities, which were reflected in missed lease payments and restructurings. A259, 262, 265-66. In approximately 2008, OSA began a cash advance loan program whereby it would send Banamex an invoice reflecting services provided to Pemex; Banamex would then loan the invoiced amounts to OSA, which OSA would repay when it eventually received payment from Pemex. A289, 291-293.

In August 2013, certain OSA employees began creating false invoices that purported to reflect receivables for services provided to Pemex; the OSA employees then used these fabricated documents to induce Banamex to issue cash advances. A301-02. This scheme continued until it was publicly revealed in February 2014. A304-05. OSA subsequently declared bankruptcy. A253.

Plaintiffs are a large and diverse group of creditors of OSA, including shipping companies that leased equipment to OSA, bondholders, and others. A257. Plaintiffs are creditors in the bankruptcy proceeding and allege that OSA owes them more than $1.1 billion dollars. A95–96. Plaintiffs also filed a lawsuit against

Citigroup in federal district court in Florida for the same $1.1 billion sought here. B38-39.

The dismissed claim Plaintiffs appeal centers on audit work that KPMG-Mexico performed for OSA regarding OSA's financial statements for 2010-12 (the "OSA Audits"). A396, 423-428. In particular, KPMG-Mexico issued audit opinions to OSA on January 25, 2012 for fiscal year 2010; on October 8, 2012 for fiscal year 2011; and on July 24, 2013 for fiscal year 2012 (collectively, the "OSA Audit Opinions"). A339-42.

B. Neither KPMG-International Nor KPMG-US Controlled KPMG-Mexico's Audit of OSA's Financial Statements.

KPMG-Mexico and KPMG-US are legally separate and autonomous member firms of KPMG-International, which was a Swiss cooperative at all relevant times and has no ownership interest in any member firm.[2] A282. KPMG-Mexico was OSA's independent auditor between 2010 and 2014, and has also been Banamex's independent auditor since at least 2005. *Id.* Neither KPMG-US nor KPMG-International participated in KPMG-Mexico's OSA audit; indeed, KPMG-International performs no audit work for any client. A381-A411. The Amended Complaint does not allege that KPMG-US or KPMG-International had any

[2] Effective October 1, 2020, KPMG-International became a private English company limited by guarantee. *See* https://home.kpmg/xx/en/home/misc/legal.html (last visited Jan. 15, 2021).

communications regarding the OSA Audits either with each other or with KPMG-Mexico. *Id.*

C. Procedural History

Plaintiffs filed their negligent misrepresentation claims in Superior Court on February 26, 2016, asserting claims against KPMG-Mexico, KPMG-International, and KPMG-US arising out of KPMG-Mexico's audit of OSA's financial statements (Count I), KPMG-Mexico's audit of Banamex's financial statements (Count II), and KPMG-US's audit of Citigroup (Count III). A44. In response to personal jurisdiction challenges from KPMG-International and KPMG-Mexico, Plaintiffs sought jurisdictional discovery and were granted certain discovery relating to the relationships between the defendants. App. Br., Ex. B 2; *id.*, Ex. C 3-5. A court-appointed Special Master, former Chancellor Chandler, found that "no work occurred in Delaware relating in any way" to the audit work at issue. *Id.*, Ex. C 11, 26, 29.

After dismissals by the Superior Court and the Court of Chancery, *see supra* 2-3, Plaintiffs filed an Amended Complaint in the Court of Chancery on September 16, 2019, relitigating only their claims against KPMG-US. A244 n.1. In their brief in opposition to KPMG-US's motion to dismiss, Plaintiffs abandoned their dismissed claims against KPMG-US based on the Citigroup and Banamex audits;

they continued to pursue only their vicarious liability claim against KPMG-US arising out of KPMG-Mexico's OSA Audits. A3098-99, 3107.

On August 21, 2020, the Court of Chancery dismissed Plaintiffs' claims with prejudice for failure to plead vicarious liability. Mem. Op. 56. The Court held that its prior dismissal—based on Plaintiffs' failure to state a claim for negligent misrepresentation—continued to govern the abandoned claims against KPMG-US (Counts II and III). *Id*. On December 1, 2020, Plaintiffs filed their appeal.

IV. ARGUMENT

A. Under Delaware and New York Law, the Amended Complaint Fails to Plead that KPMG-Mexico Performed the OSA Audit as an Agent of KPMG-US.

1. Question Presented

Whether the Court of Chancery correctly held that principal-agent liability requires that "the plaintiff must plead the principal had control *over the wrongdoing at issue*" (Mem. Op. 22 (emphasis added)) and generic allegations of influence not tied to the allegedly wrongful conduct are insufficient under Delaware and New York law.

2. Scope of Review

The standard and scope of review is "whether the trial judge erred as a matter of law in formulating or applying legal precepts."[3] The Court shall "not consider questions that have not been fairly presented to the trial court absent plain error."[4]

3. Merits of Argument

Plaintiffs have abandoned their claim, argued below, that KPMG-Mexico performed the OSA Audits as a direct agent of KPMG-US. Mem. Op. 16 n.64 (noting "direct agency" theory); App Br. 4, 8, 14-15 (arguing only "sub-agency"

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[3] *See Dunlap v. State Farm & Fire Cas. Co.*, 878 A.2d 434, 438 (Del. 2005).

[4] *See Burrell v. State*, 207 A.3d 137, 141 (Del. 2019); *see also* Del. Sup. Ct. R. 8.

theory). They now rely exclusively on a "sub-agency" theory that requires three steps: (1) KPMG-Mexico performed the OSA Audits as an agent of KPMG-International and, in turn, (2) KPMG-International controlled the OSA audit as an agent of KPMG-US. A403-07. Therefore, Plaintiffs assert, (3) KPMG-Mexico performed the OSA audit as a "sub-agent" for which KPMG-US is vicariously liable. A406-07.

Plaintiffs fail to establish *any* of these required steps, and the Amended Complaint fails to plead facts supporting agency under any applicable law. The Court of Chancery therefore appropriately held that the Amended Complaint "failed to adequately plead a theory of vicarious liability under each offered jurisdiction." Mem. Op. 10-13. Although the parties disagree whether Delaware's "most significant relationship" choice-of-law test points to the application of Mexican, New York, or Delaware law (*id.* at 10), there is no dispute that, where the law of each jurisdiction yields the same result—in this case, dismissal—the choice of law inquiry presents a false conflict, and the Court should apply the forum law of Delaware (*id.*). The parties agree with the Court's conclusion that there is no actual conflict here. App. Br. 14.

Plaintiffs now argue that "there are factual questions about the location of much of the conduct at issue" that "preclude[] a decision now on the choice-of-law issue." App. Br. 14. In the extensive briefing below regarding choice of law,

Plaintiffs never made this argument, which is not preserved for appeal. A3130-34. Nor do they identify any "factual questions" that require resolution before determining the applicable law. If necessary, this question is appropriately resolved on a motion to dismiss—particularly where, as here, Plaintiffs undertook over a year of jurisdictional discovery supervised by the Superior Court. *See* App. Br., Ex. E 2, 20-33; A44.

a. Pleading Principal-Agent Liability Requires Factual Allegations Showing Control of the Wrongdoing at Issue.

Under Delaware and New York law, the most significant requirement for a principal-agent relationship is control.[5] The Court of Chancery properly held that generic allegations of influence not tied to the wrongful conduct at issue are insufficient; to plead a viable vicarious liability claim, a plaintiff must allege facts showing that "the principal had control *over the wrongdoing at issue*." Mem. Op. 22 (emphasis added). The Amended Complaint's failure to plead this nexus between control and conduct was the fatal defect that mandated dismissal. *Id.* at

[5] *Wenske v. Blue Bell Creameries, Inc*., 214 A.3d 958, 967 (Del. Ch. 2019) (noting that "principal's inherent control over the agent's conduct" is "defining feature of the principal-agent relationship"); *Wavedivision Holdings, LLC v. Highland Cap. Mgmt. L.P*., 2011 WL 5314507, *15 (Del. Super. Ct. Nov. 2, 2011), *aff'd*, 49 A.3d 1168 (Del. 2012); *In re Air Crash near Clarence Ctr., N.Y. on Feb. 12, 2009*, 18 N.Y.S.3d 500, 505 (N.Y. Sup. Ct. 2014) ("absence of control over the daily operations" of the party was "deciding factor").

22-45. This requirement is universally applied, essential, and dispositive for the reasons explained below.

First, the Court of Chancery cited abundant Delaware authority for the widely-recognized principle that "in an agency analysis, the focus must be on authority or control *over the specific wrongdoing at issue*." Mem. Op. 27 (emphasis added); *see id.* at 25-31, 36, citing *Phoenix Canada Oil Co. Ltd. v. Texaco, Inc.*, 842 F.2d 1466, 1477-78 (3d Cir. 1988) (explaining that, for agency liability, proponent must demonstrate not only that "an arrangement exist[s] between the two corporations so that one acts on behalf of the other and within usual agency principles" but also that "the arrangement must be relevant to the plaintiff's claim of wrongdoing"); *B&B Fin. Servs., LLC v. RFGV Festivals, LLC*, 2019 WL 5849770, *3 (Del. Super. Ct. Nov. 7, 2019) (granting motion to dismiss vicarious liability claim and noting that principal is only "liable for torts committed by an agent … where the agent's tortious conduct is undertaken pursuant to the agency relationship"); *C.R. Bard, Inc. v. Guidant Corp.*, 997 F. Supp. 556, 560 (D. Del. 1998) ("[U]nder the agency theory 'only the precise conduct shown to be instigated by the parent is attributed to the parent.'"); *Mobil Oil Corp. v. Linear Films, Inc.*, 718 F. Supp. 260, 271 (D. Del. 1989) ("A vital prerequisite to imposing liability based upon customary agency principles is finding a close connection between the relationship of the two corporations and the cause of

action."); *Jurimex Kommerz Transit G.M.B.H. v. Case Corp.*, 2007 WL 2153278, *2 (3d Cir. July 28, 2007) (stating that "relevant inquiry" to assess principal-agent liability "necessarily must focus on the 'specific transaction' that gave rise to the alleged liability"); *Eisenmann Corp. v. Gen. Motors Corp.*, 2000 WL 140781, *12 (Del. Super. Ct. Jan. 28, 2000) ("When applying an agency theory, the Court should focus its inquiry on the arrangement between the corporations, the authority given in the arrangement, and the relevance of that arrangement to the Plaintiffs' claim."); *Wenske v. Blue Bell Creameries, Inc.*, 2018 WL 5994971, *4 (Del. Ch. Nov. 13, 2018) (holding that, for principal-agent liability to exist, arrangement must exist so that agent acts on behalf of principal within usual agency principles *and* "the arrangement must be relevant to the plaintiff's claim of wrongdoing"); *Hospitalists of Del., LLC v. Lutz*, 2012 WL 3679219, *16-17 (Del. Ch. Aug. 28, 2012) (noting that establishing agency liability requires plaintiffs to prove purported agent "acted at [principal's] express direction regarding any of the challenged transactions in this case"); *Albert v. Alex. Brown Mgmt. Servs., Inc.*, 2005 WL 2130607, *10 (Del. Ch. Aug. 26, 2005) (granting motion to dismiss because "plaintiffs have failed to plead sufficient facts to support a claim for agency liability" and noting that agency liability must be tethered to wrongdoing at issue).

Even in the context of a parent-subsidiary relationship—substantially closer than the relationship between the independent KPMG entities here—the parent can be vicariously liable for the subsidiary's conduct only to the extent "that the agent was acting on behalf of the principal and that the cause of action arises out of that relationship." Mem. Op. 27-28, citing *E.I. duPont de Nemours & Co. v. Rhodia Fiber & Resin Intermediates, S.A.S.*, 197 F.R.D. 112, 127-28 (D. Del. 2000), *aff'd in part, dismissed in part*, 269 F.3d 187, 198 (3d Cir. 2001) (holding that district court "correctly rejected" agency argument despite allegations of purported principal's "intimate involvement"); *Trevino v. Merscorp, Inc.*, 583 F. Supp. 2d 521, 531 (D. Del. 2008).

New York law likewise requires pleading control over the particular audit at issue. Mem. Op. 38-39. In addition to its extensive discussions of the *Parmalat* cases, the Court cited *Star Energy Corp. v. RSM Top-Audit*, which holds that generic allegations of control are not enough to plead the requisite control, and granted a motion to dismiss where the plaintiff "fail[ed] to allege that [the international entity] had any control over [the member firm] in its dealings with [the audit at issue]."[6] Plaintiffs attempt to distinguish *Star Energy* by claiming it dealt only with theories of apparent authority. App. Br. 32. This is simply incorrect: "Star Energy claims that RSM Top-Audit had *actual* authority to

[6] 2008 WL 5110919, *4 (S.D.N.Y. Nov. 26, 2008).

perform as the agent of RSM International."[7] The Court of Chancery also cited *Anwar v. Fairfield Greenwich Ltd.*, which dismissed an agency claim under New York law, holding, "Allegations of generalized control are insufficient to state a plausible claim of coordinating-entity control over its member firms in the auditing context."[8] Plaintiffs try to distinguish *Anwar* by stating that it "rested on the theory that actual control is required and '*the right to* control' does not suffice" (App. Br. 32)—but the issue in *Anwar*, as here, was not "right versus exercise" of control; rather, the dispositive point was that pleading "general" influence not tied to the specific audits at issue is insufficient.[9] Both Delaware and New York law require this crucial link between the alleged "control" and the alleged misconduct.

Second, tying principal-agent liability to control of the particular misconduct at issue is an essential limiting principle. If generic allegations—of the sort in the Amended Complaint—were sufficient to hold one entity liable for the actions of another, the scope of vicarious liability would expand exponentially beyond what existing law permits, imposing expansive liability on entities that neither engaged in nor controlled misconduct. That dramatic expansion would threaten to make KPMG-US vicariously liable for every single audit performed by every single

[7] 2008 WL 5110919 at *3 (emphasis added).
[8] 728 F. Supp. 2d 372, 461 (S.D.N.Y. 2010).
[9] 728 F. Supp. 2d at 460.

KPMG member firm around the world. That is not the law in Delaware or any other state.

Third, as the Court of Chancery observed, the requirement that control be tied to the particular misconduct at issue differentiates principal-agent liability from veil-piercing, instrumentality, or alter-ego theories that attempt to establish vicarious liability by establishing that "the complete domination and control of one entity over another" requires setting aside the corporate form. Mem. Op. 23-26, 28.[10] Because Plaintiffs do not claim that the corporate form should be set aside based on complete domination and control, they face a "narrow path to liability focused on the principal's authority and control over the agent's wrongdoing." Mem. Op. 24. Otherwise, superficial allegations of control would give rise to a total assumption of liability for all torts by another entity, without needing to demonstrate the complete domination and control required for this result. That is not the law.

For vicarious liability based only on the relationship between the parties—not based on control of the particular wrongdoing—the standard is "exclusive domination and control,"[11] not merely a "close connection" as Plaintiffs argue.

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[10] *See also Phoenix Canada Oil*, 842 F.2d at 1477-78; *Stinnes Interoil, Inc. v. Petrokey Corp.*, 1983 WL 21115, *2-3 (Del. Super. Ct. Aug. 24, 1983).

[11] Mem. Op. 23 n.91 (quoting *Wallace ex. rel. Cencom Cable Income Partners II, Inc., L.P. v. Wood*, 752 A2d 1175, 1184 (Del. Ch. 1999)).

App. Br. 5, 22-23. Plaintiffs claim that they need not allege control specific to the OSA Audits so long as they allege a "close connection" between the KPMG entities. *Id.* Yet, Plaintiffs themselves admit that they cannot ignore the required nexus between control and the OSA Audits, asserting that their burden is to plead that "the principal had a right to control *the allegedly wrongful conduct*." *Id.* at 24 (emphasis added).

Plaintiffs did not argue below that they need not allege facts showing the crucial connection between control and the OSA Audit Opinions, and this argument is, therefore, not preserved for appeal. In any event, Plaintiffs' position is plainly rebutted not only by the many cases cited by the Court of Chancery requiring control of the specific wrongdoing at issue—most of which Plaintiffs do not even attempt to distinguish—but also by the cases Plaintiffs themselves cite. *Id.* at 22-23.

Plaintiffs assert that their cases stand for the proposition that "the Delaware district court consistently has rejected motions to dismiss based merely on a close connection between the alleged principal and agent, *without more*." App. Br. 22 (emphasis added). These cases, however, say the opposite, expressly requiring a nexus with the specific wrongful conduct—as made clear by the language omitted from Plaintiffs' selective quotations. *See British Telecomms. PLC v. 1AC/InteractiveCorp*, 356 F. Supp. 3d 405, 409-10 (D. Del. 2019) (requiring

agency "relationship to be directly related to the cause of action"; holding it sufficed that plaintiffs "present a plausible factual scenario of close coordination and a joint strategy *for the use and deployment of technology and user information that are at the heart of the [allegedly infringed patents]*") (emphasis added to text omitted from Plaintiffs' parenthetical); *T-Jat Sys. 2006 Ltd. v. Expedia, Inc.*, 2017 WL 896988, *6 & n.82 (D. Del. Mar. 7, 2017) ("The fundamental question is whether the parent and subsidiary entered into a limited agency relationship for the transaction giving rise to the claim"; holding that control of allegedly infringing mobile and website applications sufficiently alleged where Expedia "facilitates the booking of hotel rooms, airline seats, car rentals, and destination services, which may be construed to relate directly to the underlying cause of action"); *StrikeForce Techs., Inc. v. PhoneFactor, Inc.*, 2013 WL 6002850, *5-6 (D. Del. Nov. 13, 2013) (noting that showing parent's dominion and control over subsidiary is insufficient to plead agency, which also requires "a close connection between the relationship of the corporations and the cause of action"; "only the conduct shown to be instigated by the parent may be attributed to the parent").

Agency liability thus requires pleading facts that show control of the wrongful conduct at issue, which the Amended Complaint does not plead.

b. Plaintiffs' Claim that They Need Not Allege Any Actual Exercise of Control Is Unpreserved, Immaterial to the Court of Chancery's Decision, and Incorrect.

Plaintiffs now argue that the Court of Chancery erroneously required allegations that KPMG-US actually exerted control over KPMG-Mexico's OSA Audits through KPMG-International, contending that allegations of a "right of control" (whether or not exercised) are sufficient. This argument misconstrues both the Court's holding and the law, and should be rejected for several reasons.

First, although featured in Plaintiffs' instant appeal, the distinction between "right to control" and "exercise of control" was not raised, much less "fairly presented," to the Court of Chancery, and is thus not preserved on appeal.[12] Prior to this appeal, Plaintiffs never addressed the supposed distinction between "right to control" and "exercise of control," themselves presenting arguments regarding whether the Amended Complaint alleged an *exercise* of control. *See, e.g.*, A3081 ("KPMG-US *exerts* real-world control over KPMGI, and KPMGI *exerts* control over its smaller member firms including [KPMG-Mexico]") (emphasis added); A3117-18 (asserting that *Parmalat* denied summary judgment because plaintiffs alleged "numerous facts indicating that GTI *exercised control* over 'the manner

[12] Del. Sup. Ct. R. 8; *Valentine v. Mark*, 2005 WL 1123370, *1 (Del. May 10, 2005) ("We will not consider this argument, as it was not fairly presented to the trial court, and the determination of this issue is not required in 'the interests of justice.'").

and method' by which" member firms did their work") (emphasis added); A3118 n.84 (characterizing "Plaintiffs' allegations [as] demonstrating that KPMG-US *exerts* significant control over KPMGI") (emphasis added). Plaintiffs cannot now fault the Court of Chancery for following the same analytical approach.[13] Plaintiffs also did not present to the Court of Chancery any of the purported authority on which they now rely to argue that exercise of control need not be pleaded.[14] App. Br. 16-17.

Second, Plaintiffs' contention that the Court of Chancery erroneously eschewed a "right to control" standard is belied by the Court's express enumeration of that very standard. The Court stated that the "defining feature of the principal-agent relationship is the principal's *right to control* the agent's conduct." Mem. Op. 24-25 (emphasis added); *see also id.* at 38 ("Under New York law, as under Delaware law, Plaintiffs must plead that the principal *had* control over the underlying conduct at issue.") (emphasis added); *id.* at 40 ("Plaintiffs fail to allege that KPMG-US or KPMG International *had* control over KPMG Mexico's conduct with respect to the OSA Audit Opinions.") (emphasis added).

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[13] *See In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 55 (Del. 2006) ("[Appellants'] argument goes beyond being not fairly presented. It borders on being unfairly presented, since the appellants are taking the trial court to task for adopting the very analytical approach that they themselves used in presenting their position.").

[14] Plaintiffs' motion to dismiss briefing did cite one of the three cases on which they now rely—but for an unrelated principle. A3123 n.99.

Third, the distinction between "right of control" and "exercise of control" was not a premise of the Court of Chancery's holding. The dispositive point—and the focus of the parties' arguments below—is the lack of any linkage between the Amended Complaint's generic allegations regarding control (whether a right or actually exercised) and KPMG-Mexico's OSA Audits. As the Court held, the fatal defect was Plaintiffs' "failure to plead that the principal's authority, *of whatever sort*, was tied to the specific act of wrongdoing." Mem. Op. 36 (emphasis added). As further discussed below, the Amended Complaint alleges neither that KPMG-US and KPMG-International had a right to control the OSA Audits nor that they exercised such control.

In their brief, Plaintiffs pluck quotes out of context to argue that the Court based its conclusion on the premise that pleading a "right to control" was insufficient. App. Br. 17. In the snippets quoted by Plaintiffs, however, the absence of any allegations that KPMG-US or KPMG-International exercised control over the OSA Audits simply illustrates the Amended Complaint's failure to allege more than generic influence. *Cf. In re Parmalat Sec. Litig.*, 375 F. Supp. 2d 278, 294 (S.D.N.Y. 2005) ("Plaintiffs have alleged further that DTT took actions in directing—or directing the removal of—auditors on the Parmalat audit.").

Fourth, although the Court of Chancery did not reach (or need to reach) the question, agency liability in this context does require pleading the actual exercise

of control. *See, e.g.*, *Patel v. Sunvest Realty Corp.*, 2018 WL 4961392, *5 (Del. Super. Ct. Oct. 15, 2018) ("Here, the Complaint fails to allege RE/MAX exerted control over Sunvest's daily operations.").

Plaintiffs do not cite a single case imposing vicarious liability based on a mere "right to control," without more. Plaintiffs rely on three cases that are all more than forty years old and readily distinguishable.[15] App. Br. 16-17. Plaintiffs first rely on the following sentence from *Billops v. Magness Construction Co.*: "A franchisor may be held to have an actual agency relationship with its franchisee when the former controls, or has the right to control, the latter's business."[16] Not only is this case specific to the franchisor-franchisee context, but the reference to "right to control" is dictum because the franchisor in *Billops exercised* tight control over its franchisee in the form of a "mandatory" operating manual that dictated the franchisee's daily operations.[17] The other two cases Plaintiffs rely on do not even mention whether a principal-agent relationship existed, but instead discuss control

[15] Plaintiffs also cite *Chrysler Corp. v. Chaplake Holdings, Ltd.* (App. Br. 26-27) for the proposition that the Amended Complaint's allegations of "right to control" are sufficient, but an agency relationship existed there only because the principal had "absolute control" of the agent's Expansion Plan at issue in the litigation and "all moves relating to the Expansion Plan required [the principal's] approval." 822 A.2d 1024, 1035 (Del. 2003).

[16] 391 A.2d 196, 197-8 (Del. 1978).

[17] *Id.* at 198.

in the context of assessing whether an employer-employee relationship existed—an entirely different test in an entirely different context.[18]

Plaintiffs incorrectly suggest that exercising control over another entity's wrongful conduct would create direct, rather than vicarious, liability. App. Br. 18. This is a new argument, not presented to the Court of Chancery, and therefore not preserved for appeal. Plaintiffs' suggestion also confuses control of misconduct with performance of misconduct. In *Parmalat*, for example, the vicariously liable entities *exercised* control over the audits at issue by taking steps such as removing audit personnel who raised questions about the specific audit work at issue—but did not themselves perform any negligent audit work that would give rise to direct liability.[19] The case that Plaintiffs now cite, *Pearson v. Component Technology Corp.*, stands only for the unremarkable principle that direct liability may be appropriate where the parent has not merely controlled another entity's misconduct, but has itself engaged in actionable misconduct.[20] Exercising control over the agent's actionable misconduct is the essential element of vicarious liability for a principal, and such control is absent here.

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[18] *See Lester C. Newton Trucking Co. v. Neal*, 204 A.2d 393, 395 (Del. 1964) (worker's compensation case); *Melson v. Allman*, 244 A.2d 85, 87-88 (Del. 1968) (applying New Jersey law).

[19] *In re Parmalat Sec. Litig.*, 598 F. Supp. 2d 569, 573-80 (S.D.N.Y. 2009).

[20] 247 F.3d 471, 487 (3d Cir. 2001).

For these reasons, Plaintiffs' newly-presented distinction between "right of control" and "exercise of control" fails to identify any error in the Court of Chancery's decision.

c. Plaintiffs Failed to Plead that KPMG-International Controlled KPMG-Mexico's Performance of the OSA Audits.

The Amended Complaint's generic allegations "fall short of alleging KPMG International has investigated or disciplined KPMG-Mexico with respect to the OSA Audit Opinions, much less controlled the content of those audits."[21] Mem. Op. 33-34. Plaintiffs fail to allege even a single communication between KPMG-International and KPMG-Mexico about the audits, much less any conduct indicating that KPMG-International intended that KPMG-Mexico would act for it with respect to the relevant audits. Indeed, Plaintiffs do not allege that KPMG-International played any role whatsoever in the OSA Audits. App. Br. 26-29.

Plaintiffs resort to a series of generalized allegations concerning the relationship between KPMG-International and KPMG-Mexico.[22] App. Br. 21-25.

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[21] Even if "right to control" the OSA audits were the proper standard, the Amended Complaint does not allege facts that show that KPMG-International had a right to control the OSA audit.

[22] A383 (alleging that KPMG-International was formed to "further or ensure the economic interests of its Members"); A385-867 (alleging that KPMG-International has sole authority to license use of KPMG name); A388 (alleging that KPMG-International requires that all member firms adopt KPMG's Global Code of Conduct); *id.* (alleging that KPMG-International can control manner and method by which KPMG member firms carry out their work); and A393 (alleging that

However, every court that has addressed comparable, and even stronger, allegations regarding control among KPMG entities and among other global networks has found them insufficient to support vicarious liability for member firm conduct.[23] The Amended Complaint does not allege that KPMG-International performed any audit work relating to the OSA Audits or any other audit. Nor does

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KPMG-International may terminate membership of member firms that act contrary to objectives, policies and regulations, or otherwise violate obligations of membership).

[23] *See Star Energy*, 2008 WL 5110919 at *4 (granting motion to dismiss where plaintiff "fail[ed] to allege that [international organization] had any control over [member firm] in its dealings with [audit at issue]"); *Nuevo Mundo*, 2004 WL 112948, *3-6 (S.D.N.Y. Jan. 22, 2004) (granting motions to dismiss of NY-based member firms and holding that they could not be held liable for conduct of Peruvian accounting firms; rejecting argument that "overall training and supervision of" Peruvian firms established principal-agent relationship); *see also McBride v. KPMG Int'l*, 2014 WL 3707977, *24-25 (N.Y. Sup. Ct. July 25, 2014), *aff'd*, 135 A.D.3d 576, 577 (N.Y. App. Div. 2016) (holding that requisite control not established by KPMG-International's "general professional standards and auditing procedures" or because KPMG "member firms must follow the rules set down by KPMG International and obey its directives," or because KPMG-International "resolves disputes and institutes controls to insure consistency of work"); *Filler v. Lernout (In re Lernout & Hauspie Sec. Litig.)*, 230 F. Supp. 2d 152, 171-73 (D. Mass. 2002) (dismissing vicarious liability claim against KPMG-International); *Howard v. Klynveld Peat Marwick Goerdeler*, 977 F. Supp. 654, 662 (S.D.N.Y. 1997), *aff'd*, 173 F.3d 844 (2d Cir. 1999) (finding "no support for a finding of agency"); *In re Royal Dutch/Shell Transport Sec. Litig.*, 380 F. Supp. 2d 509, 570-572 (D.N.J. 2005), *overruled on other grounds by*, 404 F. Supp. 2d 605 (D.N.J. 2005) (dismissing claims where KPMG-International did no auditing work in connection with audits at issue). *Cf. In re Parmalat Sec. Litig.*, 375 F. Supp. 2d at 294-95 (sustaining agency claim based on allegation that international organization was directly involved in audit at issue, actively intervening in audit decisions, including "directing—or directing the removal of—auditors on the … audit" while audit was in progress).

the Amended Complaint allege that KPMG-International intervened or participated in any way in the performance of the OSA Audit. The Amended Complaint does not even allege that KPMG-International participated in any communications regarding the OSA Audit. Plaintiffs' general allegations of influence fail to plead the requisite control *over the OSA Audits*.

Plaintiffs also argue that an Order Instituting Proceedings from the SEC (the "OIP") relating to conduct by KPMG South Africa is evidence supporting KPMG-International's control over KPMG-Mexico's OSA Audits (App. Br. 27-28), but the OIP neither shows the requisite oversight nor even addresses the relationships between KPMG-International and KPMG-Mexico or between KPMG-US and KPMG-International. A389-92. Alleging a past interaction between KPMG-International and KPMG South Africa is not sufficient to plead that KPMG-International controlled KPMG-Mexico's OSA Audits. The implication of Plaintiffs' legal theory would be that KPMG-International is liable for all audit work by every KPMG member firm around the world. Delaware and New York law do not create such unlimited vicarious liability. *See supra* 12-19.

The *Parmalat* litigation from New York (App. Br. 29-31) illustrates the dramatic exercises of control over the relevant audit work required for pleading agency in this context.[24] There, among other specific allegations illustrating

[24] *See In re Parmalat*, 375 F. Supp. 2d 278.

control, top executives from the American firm allegedly "confronted the auditors [at a different member firm] who had detected the fraud and told them to keep quiet."[25] Plaintiffs' generic allegations of influence—entirely disconnected from the OSA Audits—fall far short of the allegations in *Parmalat*, as well as the applicable pleading requirements under Delaware and New York law.

Finally, Plaintiffs suggest that agency questions are not properly addressed on the pleadings. App. Br. 19-20; *see also* Mem. Op. 22-23. But Courts commonly and appropriately address agency claims on the pleadings. *See, e.g.*, *Skye Mineral Investors, LLC v. DXS Cap. (U.S.) Ltd.*, 2020 WL 881544, *23-24 (Del. Ch. Feb. 24, 2020) (granting motion to dismiss vicarious liability claims for, *inter alia*, failure to plead agency relationship); *Baccellieri v. HDM Furniture Indus., Inc.*, 2013 WL 1088338, *10-12 (Del. Super. Ct. Feb. 28, 2013) (granting motion to dismiss for failure to plead facts supporting agency claim); *Wenske v. Blue Bell Creameries, Inc.*, 2018 WL 3337531 (Del. Ch. July 6, 2018) (same); *Compaigne des Grands Hotels d'Afrique S.A. v. Starwood Cap. Grp. Global I LLC*, 2019 WL 148454, *5-7 (D. Del. Jan. 9, 2019) (granting "motion to dismiss on Plaintiff's theory of agency liability" where plaintiff failed to plead that purported agent's wrongful acts "were due to Defendants' control, that is, were done on behalf of

[25] *Id.* at 294; *see also In re Parmalat*, 598 F. Supp. 2d at 574-76 (requiring specific intervention in Parmalat audit work at issue).

Defendants or at their direction"); *Patel*, 2018 WL 4961392 at *5 (holding that, without allegations that principal "exerted control over [agent's] daily operations … actual agency therefore is not sufficiently pleaded."); *Albert*, 2005 WL 2130607 at *10 (dismissing on the pleadings a claim where "the plaintiffs have failed to plead sufficient facts to support a claim for agency liability"); *see also Japan Petroleum Co. (Nigeria) Ltd. v. Ashland Oil, Inc.*, 456 F. Supp. 831, 838 (D. Del. 1978) (deciding agency on vicarious liability in the "interest of judicial economy" because "permitting the action to proceed to a trial on the merits without solving the agency relationship question could result in needless expenditure of time and effort"); *Eisenmann Corp. v. Gen. Motors Corp.*, 2000 WL 140781, *13 (Del. Super. Ct. Jan. 28, 2000) ("Even under the notice pleading rules, it remains incumbent on the pleader to allege some factual predicate to support the agency allegations as to the particular contract.").[26] Because the Amended Complaint sets forth no allegations whatsoever regarding KPMG-International's control over KPMG-Mexico's OSA Audit Opinions—the central element of agency—the Court

[26] Courts outside Delaware likewise address agency on the pleadings. *See, e.g.*, *Christina Trust v. Riddle*, 911 F.3d 799, 802-04 (5th Cir. 2018); *Thermal Design, Inc. v. Am. Soc'y of Heating, Refrigerating & Air-Conditioning Eng'rs, Inc.*, 755 F.3d 832, 838 (7th Cir. 2014); *Johnson v. Priceline.com, Inc.*, 711 F.3d 271, 275 (2d Cir. 2013); *Causey v. Sewell Cadillac-Chevrolet, Inc.*, 394 F.3d 285, 290 (5th Cir. 2004); *Lachmund v. ADM Investor Servs., Inc.*, 191 F.3d 777, 783 (7th Cir. 1999); *Bogenberger v. Pi Kappa Alpha Corp., Inc.*, 423 Ill. Dec. 21, 31-32 (Ill. 2018); *Robinson v. Allstate Ins. Co.*, 399 So.2d 288, 290 (Ala. 1981).

of Chancery's resolution of the vicarious liability issue on the pleadings was both appropriate and in the interest of judicial economy.

d. Plaintiffs Failed to Plead that KPMG-US Controlled KPMG-International with Respect to the OSA Audits.

The Amended Complaint fails to plead that KPMG-International acted as KPMG-US's agent with respect to the OSA Audits, and therefore fails to plead that KPMG-US controlled KPMG-Mexico's OSA Audits through an intermediary. Mem. Op. 33. In particular:

- As an initial matter, because the Amended Complaint does not plead that KPMG-International controlled KPMG-Mexico's OSA Audit Opinions, KPMG-US could not have controlled the OSA Audit Opinions *through* KPMG-International as required for Plaintiffs' sub-agency theory.
- The Amended Complaint does not allege that KPMG-International performed any audit work—relating to the OSA Audit or any other audit.
- KPMG-US accounted for a minority of KPMG-International's income. A403; App. Br. 21.
- The existence of a few shared personnel, including a minority of KPMG-International's Global Management team (A404), does not create control.
- The allegation that the Global Head of Audit for KPMG-International has responsibility to "globally drive audit quality and innovation across KPMG-International's member firms" is inconsistent with the conclusion that KPMG-US controls KPMG-International. *Id*.
- The allegation that a group of KPMG-US employees (from the Department of Professional Practice) liaises with KPMG-International does not imply control. A405.

- The allegation that KPMG-US is one of four "founding members" of KPMG-International (A406) does not establish control.

These generic allegations fall short of pleading control with respect to the OSA Audits, as required under New York and Delaware law, and also compare unfavorably to the allegations in *Parmalat*. *See In re Parmalat*, 598 F. Supp. 2d at 578 (permitting agency liability claim to proceed where, among other forms of control, US firm had "the power to veto significant decisions related to GTI governance and structure").

Plaintiffs' only attempt to tie KPMG-US to the OSA Audits is their argument that "there was overlap between KPMG-Mexico's OSA and Banamex audits and KPMG-US's Citigroup/Banamex audits"[27] and this overlap yields an inference that "KPMG-US and [KPMG-Mexico] … did not audit different sides of these transactions independently." App. Br. 25, 28. As the Court of Chancery concluded, this supposed "overlap [] does not … establish that KPMG US, which was only directly involved in the Citigroup audit, wielded the necessary control over the content of the OSA Audit Opinions." Mem. Op. 32. Indeed, KPMG-Mexico was the sole auditor for both OSA and Banamex (A139), and Plaintiffs' allegations do not yield an inference that KPMG-US, by auditing Citigroup,

[27] Plaintiffs' reference to "KPMG-US's Citigroup/Banamex audits" is misleading and inaccurate. Only KPMG-Mexico audited Banamex's financial statements. A343-349.

somehow controlled KPMG-Mexico's OSA Audits. Moreover, this argument appears to be a vestige of Plaintiffs' abandoned-after-dismissal argument for direct agency; it does not relate to KPMG-International (which performs no audit work) and thus does not bolster Plaintiffs' sub-agency contention that KPMG-International controlled the OSA Audit Opinions (or that KPMG-US controlled KPMG-International with respect to the OSA Audit Opinions).

Thus, under Delaware and New York law, the Amended Complaint does not plead a principal-agent relationship between KPMG-International and KPMG-Mexico, between KPMG-US and KPMG-International, or between KPMG-US and KPMG-Mexico.[28]

[28] The Court of Chancery properly resolved this issue on the pleadings. *See supra* 28-30.

B. Under Delaware and New York Law, the Amended Complaint Fails to Plead that KPMG-Mexico Performed the OSA Audit As Part of a Joint Venture with KPMG-US.

1. Questions Presented

Whether the Court of Chancery correctly held that Plaintiffs' conclusory allegations were insufficient to plead a joint venture under Delaware and New York law.

2. Scope of Review

The standard and scope of review is "whether the trial judge erred as a matter of law in formulating or applying legal precepts."[29] The Court shall "not consider questions that have not been fairly presented to the trial court absent plain error."[30]

3. Merits of Argument

a. The Court of Chancery Properly Decided the Issue on the Pleadings.

The Court of Chancery properly noted that it could determine on a motion to dismiss whether a joint venture was sufficiently pleaded. Mem. Op. 52 n.198 (citing *Wenske*, 2018 WL 5994971, *8 (granting motion to dismiss where "facts and circumstances as pled here … do not support a reasonable inference that BB GP and BB USA formed a joint venture to manage BB LP")). Plaintiffs' argument

[29] *See Dunlap*, 878 A.2d at 438.
[30] *See Burrell*, 207 A.3d at 141; *see also* Del. Sup. Ct. R. 8.

that the existence of a joint venture cannot be determined on the pleadings as a matter of law (App. Br. 34-35) is unavailing for two reasons.

First, this new argument was not preserved.[31] In the briefing below regarding joint venture, Plaintiffs never argued that the existence of a joint venture was unsuitable for resolution on the pleadings. A3125-29.

Second, courts commonly and appropriately decide this issue on the pleadings. *See, e.g.*, *Wenske*, 2018 WL 5994971 at *8; *First State Orthopaedics, P.A. v. Gallagher Bassett Servs., Inc.*, 2018 WL 2733344, *6-7 (Del. Super. Ct. May 3, 2018) (granting motion to dismiss joint venture claim); *N.S.N. Int'l Indus., N.V. v. E.I. DuPont De Nemours & Co.*, 1994 WL 148271 (Del. Ch. Mar. 31, 1994) (holding, on motion to dismiss, that no joint venture existed because, among other reasons, operative agreements did not contemplate sharing of losses); *J. Royal Parker Assocs., Inc. v. Parco Brown & Root, Inc.*, 1984 WL 8255 (Del. Ch. Nov. 30, 1984) (granting motion to dismiss joint venture claim).[32]

The cases cited by Plaintiffs (but not presented to the Court of Chancery) do not suggest otherwise. *See Warren v. Goldringer Bros., Inc.*, 414 A.2d 507, 508

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[31] Del. Sup. Ct. R. 8

[32] Courts outside Delaware likewise address joint venture on the pleadings. *See, e.g.*, *Blessing v. United Steel, Paper & Forestry, Rubber, Mfg., Energy, Allied Indus. & Serv. Workers Int'l Union*, 244 Fed. App'x. 614 (6th Cir. 2007); *Jacobsen v. Marin Gen. Hosp.*, 192 F.3d 881, 887 (9th Cir. 1999); *Flip Mortg. Corp. v. McElhone*, 841 F.2d 531, 539-40 (4th Cir. 1988); *Boyd v. Kilpatrick Townsend & Stockton*, 164 A.3d 72, 83 (D.C. 2017).

(Del. 1980) (affirming lower court's finding that substantial evidence adduced at trial supported joint venture; not addressing propriety of addressing joint venture on motion to dismiss); *In re Coffee Assocs., Inc*, 1993 WL 512505, *5 (Del. Ch. Dec. 3, 1993) (granting summary judgment dismissing petition for dissolution of joint venture where petitioner failed to show parties intended to create joint venture).[33]

Thus, the Court of Chancery properly resolved the issue of joint venture on the pleadings, and Plaintiffs are precluded from arguing otherwise.

b. The Amended Complaint Fails to Plead a Joint Venture.

New York and Delaware law preclude joint venture liability (Mem. Op. 51-55), and Plaintiffs cannot avoid the abundant case law holding that members of global auditing networks are not vicariously liable for the conduct of separate and legally independent firms by recasting agency claims as joint venture claims. Delaware law regarding joint venture liability requires "(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 which may be sustained."[34] The parties agree

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[33] Plaintiffs also rely on a Special Master's report, which they assert elsewhere was "nullif[ied]" by the Superior Court's subsequent holding that it lacked subject-matter jurisdiction. App. Br. 11.

[34] *Warren*, 414 A.2d at 509 (internal citations and quotation marks omitted).

that the elements of joint venture are substantially the same under Delaware and New York law (App. Br. 36 n.9), which provides:

> A joint venture is a special combination of two or more persons where in some specific venture a profit is jointly sought. The indicia of the existence of a joint venture are: (i) acts manifesting the intent of the parties to be associated as joint venturers; (ii) mutual contribution to the joint undertaking through a combination of property, financial resources, effort, skill or knowledge; (iii) a measure of joint proprietorship and control over the enterprise; and (iv) a provision for the sharing of profits and losses.[35]

As the Court of Chancery noted, pleading joint venture in the context of a network would "require[] allegations that raise 'an inference that each firm had an equal right to direct the policies of another firm' *with regard to the audits at issue*." Mem. Op. 53 (emphasis added) (quoting *In re Parmalat Sec. Litig.*, 501 F. Supp. 2d 560, 590 (S.D.N.Y. 2007), *aff'd sub nom. Pappas v. Bank of Am. Corp.*, 309 Fed. App'x 536 (2d Cir. 2009)).

While Plaintiffs are required to satisfy each of these elements, they fail to plead any of them.

First, Plaintiffs fail to allege that KPMG-US and KPMG-International had an equal right to direct KPMG-Mexico's performance of the OSA Audits.[36] These

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[35] *Decker, Decker & Assocs., Inc. v. Ass'n of Nat'l Advertisers, Inc.*, 2007 WL 1053881, *5 (N.Y. Sup. Ct. Apr. 10, 2007).

[36] *See Bondi v. Grant Thornton Int'l (In re Parmalat Sec. Litig.)*, 421 F. Supp. 2d 703, 718 (S.D.N.Y. 2006) (holding under Illinois law, which has same

audits were performed exclusively by KPMG-Mexico, and the Amended Complaint does not allege that KPMG-US or KPMG-International participated in or directed these audits in any way.[37] The failure to plead control by KPMG-US and KPMG-International over the OSA Audits, *see supra* 12-19, is fatal to Plaintiffs' joint venture claim. Perhaps recognizing this deficiency, Plaintiffs artificially aggregate audits that are not at issue on this appeal, asserting that KPMG-Mexico, KPMG-US, and KPMG-International "shared resources, funds, and personnel to provide professional services to Citigroup, Banamex, and OSA." App. Br. 37-38. But even this artifice does not suggest KPMG-US or KPMG-International directed KPMG-Mexico's OSA Audits.

Second, Plaintiffs fail to allege, as required, that KPMG-US, KPMG-International, and KPMG-Mexico intended to form a joint venture or entered into any agreement to do so.[38] Plaintiffs' conclusory assertions (App. Br. 37) include no

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elements as New York law, that failure to allege joint control *with respect to audits at issue* precluded joint venture); *see also In re Parmalat Sec. Litig.*, 501 F. Supp. 2d at 590 (S.D.N.Y. 2007) (applying *Bondi* under New York law).

[37] Plaintiffs also assert that "KPMGM and KPMG Singapore coordinated multiple activities in the OSA engagement." App. Br. 9. This is irrelevant to the joint venture analysis, because the Amended Complaint: (1) does not allege that KPMG Singapore is part of the purported joint venture; and (2) alleges that KPMG Singapore audited an OSA affiliate in connection with that affiliate listing its bonds on the Euro MTD Market or Luxembourg Stock Exchange—work unrelated to the OSA Audit Opinions.

[38] *See Mawere v. Landau*, 2013 WL 2217757 (N.Y. Sup. Ct. May 15, 2013), *aff'd in part and modified in part*, 130 A.D.3d 986 (N.Y. App. Div. 2015) (holding that joint venture requires agreement manifesting intent to enter joint venture).

facts from which one might reasonably infer that KPMG-US, KPMG-Mexico, and KPMG-International agreed (or even intended) to audit OSA together.

Third, Plaintiffs fail to identify any factual allegations indicating that the entities undertook mutual promises to share profits and losses.[39] On a motion to dismiss, "conclusory allegations unsupported by specific facts" should not be "blindly accept[ed]."[40]

Fourth, Plaintiffs do not allege that the KPMG entities had the ability to direct *each other's* conduct with respect to the OSA and Citigroup audits, but, if anything, attempt unsuccessfully to allege that KPMG-US controls KPMG-International and that KPMG-International in turn controls KPMG-Mexico.[41] Plaintiffs assert that they established joint control by alleging that KPMG-US, KPMG-Mexico, and KPMG-International "'police[d] one another's day-to-day conduct'" through periodic reviews, but the Amended Complaint: (1) alleges that

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[39] *See Mawere*, 2013 WL 2217757 at *6 ("[A]n agreement to share the losses of a joint venture is an indispensable element of finding the existence of a joint venture."); *First Keystone Consultants, Inc. v. DDR Constr. Servs.*, 2009 WL 3415282, *3 (N.Y. Sup. Ct. Oct. 5, 2009), *aff'd in part and modified in part*, 74 A.D.3d 1135 (N.Y. App. Div. 2010) ("A sufficiently definite agreement with respect to the sharing of profits and losses is an indispensable element of any joint venture agreement.").

[40] *Nemec v. Shrader*, 991 A.2d 1120, 1125 (Del. 2010).

[41] *See Bondi v. Grant Thornton Int'l (In re Parmalat Sec. Litig.)*, 377 F. Supp. 2d 390, 407 (S.D.N.Y. 2005) (allegations that international firm removed partner of member firm cut against existence of joint venture by suggesting that control was in province of international firm); *Bondi*, 421 F. Supp. 2d at 717 (same).

reviews occurred once every three years, (2) alleges that only personnel from member firms, not KPMG-International, participated in reviews, and (3) does not allege that anyone from KPMG-US ever reviewed KPMG-Mexico. A414.

Plaintiffs also assert that joint control is "especially clear for the OSA audits" because OSA engaged in the transactions at issue with Banamex, and thus the audits for OSA and Banamex "had to align." App. Br. 38. But the Amended Complaint: (1) alleges that only KPMG-Mexico audited the financial statements of Banamex and OSA, so the alleged "overlap" would not have involved KPMG-US or KPMG-International; (2) does not allege any overlap in personnel or coordination as between the OSA and Banamex audits (much less the Citigroup audits performed by KPMG-US); and (3) does not allege that the personnel auditing Banamex's financial statements collaborated with the personnel auditing the financial statements of an arm's length counterparty to Banamex transactions (OSA).

Plaintiffs thus failed to plead any element of a joint venture.

C. The Amended Complaint Fails to Plead Vicarious Liability Under Mexican Law.

1. Questions Presented

Whether the Court of Chancery correctly held that, under Mexican law, vicarious liability pursuant to a principal-agent or joint venture relationship requires a written agreement expressly creating such a relationship.

2. Scope of Review

The standard and scope of review is "whether the trial judge erred as a matter of law in formulating or applying legal precepts."[42]

3. Merits of Argument

Mexican law requires a written agreement for both agency and joint venture. Mem. Op. 17-21, 47-51. The parties agree that the Mexican legal system is based on rules and statutes rather than cases. *Id.* at 17-18. In Mexico, cases are typically litigated based on the language of the rules and statutes, without invoking judicial precedent. B4; A3175. In this case, the applicable rules and statutes do not permit vicarious liability without a written agreement expressly creating an agency or joint venture relationship—and no cases cited by Plaintiffs suggest otherwise.

[42] *See Dunlap*, 878 A.2d at 438.

a. Agency Requires a Written Agreement Under Mexican Law.

Under Mexican law, an agency relationship requires a written agreement expressly creating such a relationship when the amount involved is more than approximately $200. Mem. Op. 18; B13. As the Court noted, the operative statutes are Article 2546, 2555, and 2556 of the Mexican Federal Civil Code. *See* B12-B13. Article 2546 requires a contract for the creation of an agency relationship: "Agency is a contract by which the agent obligates himself to execute for the account of the principal the juridical acts which the latter confides to him." C.C.D.F. art. 2546; B12. Articles 2555 and 2556 require that "the agency contract must be ratified in writing when the amount involved is more than approximately $200." Mem. Op. 18; B13.

Plaintiffs argue that Article 2546 is limited to a power of attorney relationship and that such a relationship is not applicable here.[43] App. Br. 44. But Article 2546 would apply here even if it were limited to "power of attorney" as understood in Mexico: "In Mexico, power of attorney is a far more generalized agency relationship used in a variety of settings including commercial transactions and corporate structures." Mem. Op. 18-19. Plaintiffs argue that the Court's

[43] Plaintiffs claim that the Court of Chancery "recognized the limitation of Article 2546 to a power of attorney." App. Br. 44 (citing Mem. Op. 18). But the Court noted only that "Plaintiffs argue" this point. Mem. Op. 18.

authorities for this conclusion (Mem. Op. 18 n.76) do not "suggest 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." App. Br. 44. In fact, the law review article cited by the Court states that, pursuant to Article 2546, the authority of an agent "must be specifically granted through a formal document (power of attorney)."[44] In any event, the Court cited these authorities only for the proposition that Mexican "power of attorney" encompasses the type of agency relationship that Plaintiffs seek to establish—and, thus, Article 2546 provides the applicable rule even if Plaintiffs are correct that it is limited to "power of attorney." Mem. Op. 18.

Plaintiffs suggest that the Court should have followed cases holding that, even without a written agreement, a hospital may be vicariously liable for medical services provided on its premises. App. Br. 44. As the Court of Chancery noted, the motivating principle in these cases—that denying vicarious liability in this narrow context would "undermin[e] the values and principles that prevail in the human right to health and the rights of users"—was "absent from the matter at hand." Mem. Op. 20. In response, Plaintiffs conclusorily assert that these "factual

[44] Humberto Gayou & Robert G. Gilbert, *Legal Building Blocks for Structuring Sales in the Mexican Market*, 25 St. Mary's L.J. 1115, 1136 (1994) (citing C.C.D.F. art. 2546).

differences are irrelevant" (App. Br. 44), but do not even try to explain why this public policy exception to the statutory rule might apply here.

Plaintiffs have not and cannot identify a written agreement expressly creating an agency relationship that Mexican law requires. To the contrary, the written materials referenced in the Amended Complaint[45] clarify the independence of member firms like KPMG-Mexico and KPMG-US. For example, KPMG-International's website stated at all relevant times:

> KPMG International is a Swiss entity. Member firms of the KPMG network of independent firms are affiliated with KPMG International. KPMG International provides no client services. No member firm has any authority to oblige or bind KPMG International or any other member firm vis-à-vis third parties, nor does KPMG International have any such authority to obligate or bind any member.[46]

Thus, the Court of Chancery correctly held that Plaintiffs failed to plead an agency relationship under Mexican law.

b. Joint Venture Liability Requires a Written Agreement Under Mexican Law.

As the Court of Chancery held, Mexican law "requires a written agreement to establish a joint venture between KPMG International, KPMG US, and KPMG

[45] *See, e.g.*, A384 (KPMG-International Annual Review for 2014), A397 (KPMG-Mexico website), A415 (KPMG-International website).

[46] B730; *see also* B739 (KPMG-Mexico website stating that KPMG-Mexico is not agent of KPMG-International); B784 (KPMG-International Annual Review for 2014); B790 n.1 (KPMG Global Code of Conduct).

Mexico." Mem. Op. 48. As the Court noted, C.C.D.F. Article 1988 states in relevant part, "Solidarity [joint liability] is not presumed; it results from the law or from the will of the parties." *Id.* at 47; B14.

Plaintiffs, recognizing that liability under Mexican law exists only to the extent created by statute (B4, B803; A3175), argue that Article 1917 of the Mexican Federal Civil Code permits joint liability without a written agreement by stating that "all parties that cause a common injury are jointly liable for [the] damages" caused to the victim.[47] App. Br. 45. But Plaintiffs do not allege that KPMG-US and KPMG-International *caused* an injury to them; they allege that KPMG-US should be held *vicariously* liable for an injury that KPMG-Mexico purportedly caused. The plain language of Article 1917 neither creates vicarious liability nor provide a basis for treating independent entities as a joint venture. B15. As the Court of Chancery noted, the only case Plaintiffs cited, consistent with the plain language of Article 1917, "does not conflate separate entities into one joint venture." Mem. Op. 50.

Thus, Plaintiffs failed to plead a joint venture under Mexican law.

[47] Plaintiffs have abandoned their primary argument made below regarding joint ventures under Mexican law. Mem. Op. 48-50.

V. CONCLUSION

For the reasons above, this Court should affirm the dismissal of the Amended Complaint.

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