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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Janus Ruling Revives China Expert Auditor's Dismissal Bid

By **Ian Thoms**

Law360, New York (August 11, 2011) -- A New York auditing firm will get another shot at dismissing a shareholder class action accusing it of aiding China Expert Technology Inc.'s \$132 million fraud in light of the U.S. Supreme Court's Janus decision, a federal judge ordered Tuesday.

In a handwritten note, U.S. District Judge Alvin K. Hellerstein said he would reconsider his refusal to dismiss the shareholder action against PKF New York based on the high court's June ruling in *Janus Capital Group Inc. v. First Derivative Traders* — which the Ninth Circuit has said sets "the pleading bar even higher in private securities fraud actions seeking to hold defendants primarily liable for the misstatements of others."

The auditing firm, which plaintiffs say was complicit in the fraud because it did not properly survey the Chinese company's financial statements, said the Janus decision removes any doubt that the case should be dismissed.

"It is now indisputably clear that only the actual 'maker' of an allegedly fraudulent statement may be subject to a private securities claim," PKF New York said in a motion.

Judge Hellerstein said he would at least entertain the defendant's argument and agreed to hold a rehearing on its motion to dismiss.

The case stems from the nearly complete collapse of China Expert's stock in the summer and fall of 2007. In addition to PKF New York, the plaintiffs sued fellow China Expert auditors PKF Hong Kong and BDO McCabe Lo Ltd., alleging faulty accounting.

Judge Hellerstein has not agreed to reconsider his refusal to dismiss the case against PKF Hong Kong and BDO.

China Expert, based in Shenzhen, China, launched a U.S. initial public offering in 2004 using the reverse merger practice. In such an IPO, companies purchase an existing American shell company and issue stock through it.

The process has recently drawn the scrutiny of regulators and aggrieved investors.

According to the investors' fourth amended complaint filed in April, China Expert released its fiscal statements for fiscal 2005 in March 2006. The financial statement also included audited financial statements for fiscal 2003 and 2004.

The financial statements reported that China Expert had 16 contracts to build government

computer systems in China, with each of those contracts to be performed on an ongoing basis, according to the complaint. The company also claimed to have \$53.5 million worth of accounts receivable from 2003 through 2006.

In addition, China Expert also reported increasing revenue of \$5.7 million in 2003, \$26.8 million in 2004, \$35.6 million in 2005 and \$66.1 million in 2006, plus \$13.2 million for the first quarter of 2007, the complaint says.

The plaintiffs allege that the two PKF units and BDO McCabe failed to “perform rudimentary auditing procedures” to determine that the contracts actually existed. In fact, a private investigator hired by the plaintiffs discovered that, for the most part, they did not.

Rather than having over \$132 million in revenues, China Expert had less than \$1 million for the relevant period, the complaint alleges.

The company's stock, which topped out at over \$8 at the height of the Nov. 14, 2006, through Oct. 1, 2007, class period, fell to 10 cents per share by mid-October 2007. Trading in the shares now occurs in the over-the-counter market and China Expert is facing enforcement proceedings from the U.S. Securities and Exchange Commission.

PKF and BDO McCabe, the predecessor to BDO Ltd. and a unit of accounting giant BDO International Ltd., have denied that their audits were faulty.

The plaintiffs are represented by Timothy W. Brown, Laurence Rosen and Phillip Kim of the Rosen Law Firm PA.

PKF New York is represented by Thomas R. Manisero and William J. Kelly of Wilson Elser Moskowitz Edelman & Dicker LLP.

PKF Hong Kong is represented by Michael C. Tu, Steven J. Fink and Charles J. Ha of Orrick Herrington & Sutcliffe LLP.

BDO McCabe is represented by Peter A. Wald, James J. Farrell, Matthew L. Kutcher and Cameron Smith of Latham & Watkins LLP.

The case is *Munoz v. China Expert Technology Inc.*, case number 1:07-cv-10531, in the U.S. District Court for the Southern District of New York.

--Additional reporting by Evan Weinberger. Editing by John Quinn.