STATE OF MINNESOTA
IN COURT OF APPEALS
A06-1309

Julia A. Christians, Trustee for the Bankruptcy Estate of Technimar Industries, Inc.,

Appellant,

v.

Grant Thornton, LLP,

Respondent.

APPELLANT'S BRIEF

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> The District Court granted summary judgment to the auditor on these grounds.

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Statement of the Case

This is an appeal from a summary judgment entered in District Court, Hennepin County, Minnesota, Hon. John Q. McShane, Judge. The action was brought by Julia A. Christians, as Trustee for the Bankruptcy Estate of Technimar Industries, Inc., alleging generally auditor malpractice (both negligence and breach of contract) by Grant Thornton, LLP, in connection with its audit of the financial statements of Technimar Industries, Inc. ("Technimar"). The case had been scheduled for a July 2006 trial, but in late May, the District Court granted Grant Thornton's motion for summary judgment, and this appeal followed.

Statement of Facts

Although the record is large,[1] and although there are some key factual disputes in this appeal from a summary judgment, the general facts are not in dispute. Appellant is the bankruptcy trustee for Technimar Industries, Inc. ("Technimar"), a failed start-up manufacturer respecting which the big losers as

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[1] This case has involved a huge volume of discovery, including review of thousands of documents from third-party sources. The materials deemed relevant, including deposition transcripts, were generally submitted to the Court as exhibits to counsel's affidavits in connection with the motion for summary judgment. Many of the documents were identified as deposition exhibits numerous times; where those documents were also exhibits to Plaintiff's Complaint, for ease of reference, they are generally identified herein by reference to the exhibits to the Complaint included in Appellant's Appendix. There was a stipulation and order for confidentiality in the action, and the materials claimed as confidential by Grant Thornton were filed under seal by both parties. Because of the confidentiality restrictions, testimony and documents labeled as confidential by Grant Thornton are not reproduced in the Appendix or the Supplemental Record, and are referred to as exhibits to counsel's affidavits in the District Court record, pursuant to Appellate Rule 128.03 and the Advisory Committee Notes thereto.

investors and creditors were various Minneapolis police and firefighter pension funds. This appeal arises in the bankruptcy trustee's auditing malpractice action against Technimar's auditor, Grant Thornton, LLP ("Grant Thornton"). In May 1997, Grant Thornton issued an unqualified audit opinion respecting Technimar's 1996 financial statements showing that Technimar had a positive net worth of over $10 million, with assets including a $16 million deposit on equipment. The equipment was to be used to manufacture and sell under an exclusive license in the U.S. a product considered superior to DuPont Corian, granite, and similar products used for high-end countertops and similar applications. Grant Thornton also issued a "Debt Compliance Letter" certifying that Technimar was in compliance with certain restrictive covenants in its secured financing.

Within just a few months after receipt of the Grant Thornton audit, Technimar was broke. Its primary secured creditor gave notice of default and called its loan. Its major creditors replaced Technimar's management with a turnaround consultant, Coy & Associates, but the rescue effort was unsuccessful, and Technimar filed for reorganization in bankruptcy. That effort too was unsuccessful, and the bankruptcy case was converted to a Chapter 7 liquidation, with Appellant Julia A. Christians appointed Trustee. As is common practice, she sought financial records from the bankrupt's accountants and auditors. After the bankruptcy court issued a "turnover" order in December 2000 (A. 169), Grant Thornton produced its audit files. After substantial investigation, the Trustee filed suit against Respondent Grant Thornton for auditor malpractice, negligence, and breach of contract. After extensive discovery, and on a vast record, the District Court granted summary judgment to Grant Thornton. The detailed facts are described below.

Background

The sad story starts in Mexico. Roberto Contreras, Sr., was at one time a major industrialist within the Mexican oil industry. After political problems with the then-ruling party in Mexico, Roberto, Sr., moved his family to the United States, settling in Houston, Texas. They became involved in stone-fabrication businesses, selling finished stone countertop products and the like. Technimar was organized for that purpose.

Sometime in 1994, a business opportunity arose. A company in Italy, Breton, S.p.A. ("Breton"), had developed a proprietary manufacturing process for an "agglomerated stone" product, basically made from certain sands and other quartz-bearing minerals, the final product reputedly being superior to natural stone, such as granite, and to synthetic products, such as DuPont "Corian." Roberto, Sr., was impressed, and made a deal with Breton to have an exclusive right to manufacture the "Bretonstone" product in the United States, and to acquire from Breton the necessary manufacturing equipment for approximately $16 million. Technimar paid Breton over $2 million as an initial deposit.

Although Technimar had paid $2 million down for manufacturing equipment and exclusivity rights, it still needed a manufacturing facility and capital. The apparent but unlikely solution came from Minnesota, in the form of one David Welliver. Welliver was an investment adviser and fund manager who was handling investments for several Minneapolis police and fire pension funds. A native of the Grand Rapids area, Welliver suggested that Technimar move from Texas to Minnesota and establish its manufacturing plant in Welliver's home town, Cohasset. He assured the Contreras family that with his contacts in Minnesota he could raise the money necessary for Technimar to manufacture its "Stonite" product under the exclusive license from Breton. Market studies and sales projections were extremely positive.

For a time, all seemed well. Through a private placement offering in early 1996, Welliver raised over $12 million for Technimar. One of Welliver's clients, the Minneapolis Police Relief Association ("MPRA"), was persuaded to invest $5 million of its pension fund money in Technimar stock, and also made debt investments in Technimar, with its 1996 promissory notes generally due in early 1998. Other Minneapolis police and fire pension funds made debt and equity investments in Technimar.

The debt and equity capital permitted Technimar to make substantial payments to Breton on the equipment contract, but by mid-1996, Breton was still owed approximately $8.4 million. More money was needed to bring the project to fruition. Welliver put a deal together to raise another $12 million. Under the deal, the City of Cohasset would issue an industrial revenue bond for $12 million, to be sold or assigned to Heller Financial, Inc. ("Heller"). A manufacturing facility would be built in Cohasset, by a partnership of Minnesota Power and M. A. Mortenson Company, to be leased to Technimar.

The proceeds from the bond deal were to be used primarily to pay off the balance owed on the Breton equipment contract. Heller was to obtain a first security interest in both the Breton equipment to be delivered and in Technimar's rights under the exclusive equipment contract. Heller (rightly, as it turned out) was leery of relying upon undelivered equipment outside the country as collateral security, and demanded additional financial support for the credit facility to Technimar, a start-up company, and got it—the City of Cohasset guarantied a portion of the $12 million bond obligation, as did the Iron Range Resource and Rehabilitation Board ("IRRRB"). $500,000 of the IRRRB guaranty was supported by a personal guaranty of Roberto Contreras, Sr. The balance of required financial support was to be provided by a collateral pledge of $7.6 million by one of Welliver's companies, Valent Venture & Growth ("Valent"), later known as Rothschild Venture & Growth ("RVG"). The pledge was to be cash, invested in cash-equivalent government securities on deposit with Norwest Bank for the benefit of Heller.

A requirement for the bond financing was that Technimar provide Heller with audited financial statements subsequent to closing of the financing. Technimar shopped around, obtained several proposals, including one from Grant Thornton (Complaint, Ex. F; A. 56-76). Technimar ultimately was persuaded to retain the Grant Thornton firm to audit its 1996 financial statements.

The $12 million Heller bond financing closed in late December 1996. There were some bumps and delays along the way. With hindsight, it is obvious that Welliver did not have the money to provide the $7.6 million security deposit required by Heller. In September 1996, Welliver persuaded Breton to invest $7.6 million of its proceeds from the Heller financing in his Valent fund. Heller required a cash pledge, and Valent, using the cash proceeds from the Heller loan directed to Breton, would guarantee $7.6 million of the Heller loan obligation, secured by a pledge of the bond proceeds. The pledge would provide that the pledged funds could not be withdrawn until the Heller debt had been paid in full, scheduled for twelve years later. Breton did not want to be tied up that long, and by an agreement entered into September 6, 1996 (the "September Agreement"), it was agreed that Breton would make the investment in Valent, but that thereafter Technimar would buy $4 million of Breton's Valent shares, and Valent would buy $3.6 million from Breton. Breton would then inject a $1 million investment into Technimar, for common stock. (A. 44-47).

The contemplated buy-back of Breton's investment in Valent was not a secret; it was well-known to participants in the bond financing (including City of Cohasset, IRRRB, and Minnesota Power and M.A. Mortenson) that Breton's investment in Valent would be bought back as funds became available.[2] The September Agreement was presented to and ratified by the Technimar Board of Directors in an "extraordinary meeting" on September 25, 1996. (A. 48-9).

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2 Affidavits of Rick Anderson, ¶ 7; Mark Phillips, ¶ 7; William Fahey, ¶_9.

The transactions contemplated under the September Agreement were to have been completed by October 30, 1996; that did not happen, as closing of the Heller loan was delayed. The September Agreement among Valent, Breton, and Technimar was modified by a December 20, 1996, agreement (the "December Agreement"), signed by Breton, Welliver, and Roberto Contreras, Sr. The December Agreement required Technimar to pay Breton as follows:

$1.0 million prior to 12/30/96

$1.2 million by 1/31/97

$2.0 million by 2/28/97

$2.4 million by 3/31/97

By reason of the December amendment, Technimar became obligated to pay $6.6 million to Breton by March 31, 1997, to redeem Breton's Valent investment and to obtain delivery of the equipment. Unlike the September Agreement, the December Agreement was not ratified by or known to the Technimar Board of Directors.

In December 1996, the Technimar Board of Directors passed a resolution authorizing the Heller financing. (S.R 470). The proceeds of the $12 million Heller financing were distributed essentially as follows:

- $800,000 to Breton;
- $7.6 million to RVG for Breton's investment in RVG, pledged to secure the Heller loan;

- $360,000 to Juran & Moody as its placement fee;
- $40,000 to Winthrop & Weinstein as counsel for Juran & Moody;
- $65,000 to Katten, Muchin & Zavis as counsel for Heller;
- $60,000 to Heller as its loan closing fee; and
- $3,075,000 to Technimar.

The consequence of the Heller financing and Technimar's obligation to purchase Breton's RVG investment was that out of a $12 million bond financing, Technimar received $3,075,000 net of the closing costs and fees and payments to or for the account of Breton, in exchange for which Technimar had a $12 million debt to Heller to service, plus a $7.6 million obligation to Breton to purchase its RVG securities, without payment for which Breton would not deliver the equipment. Without prior payment of the $12 million Heller obligation, which was necessary to obtain release of the collateral account, the RVG securities Technimar was obligated to purchase from Breton were essentially worthless; assets of the RVG limited partnership consisted primarily of Technimar stock.

The Heller loan documents contained various negative covenants and restrictions, including one prohibiting Technimar from making any investments in anything other than cash equivalents; Technimar's required redemption of Breton's investments in Welliver's fund accordingly violated the loan covenants. (Heller default letter, A. 53-5; Schoultz Depo., pp. 41-2, 91-95,Conn Aff. Ex. P).

Grant Thornton began its auditing work in early 1997, and on or about May 15, 1997, issued its unqualified opinion that the audited financial statements presented "in all material respects the consolidated financial position of Technimar . . . as of December 31, 1996 . . . in conformity with generally accepted accounting principles." (A. 88-9).

The audited financial statements showed $26,260,863 in total assets and $16,255,655 in liabilities, for a net worth of just over $10 million. The Assets included, without qualification, a $16 million deposit on the Breton machinery and equipment, but the Liabilities did not disclose the $7.6 million remaining obligation to Breton, and the accompanying notes did not disclose that obligation or that delivery of the equipment was contingent on satisfaction of the obligation to Breton.

As was required under the Heller loan transaction, Grant Thornton also provided its "Debt Compliance Letter" (A.117-19), confirming that there were no defaults or events of default under the Heller security agreement. In addition, Grant Thornton's notes to the audited financial statements recited that a "security agreement between the purchaser of the bond [Heller] and the Company contains certain restrictive covenants, for which the Company is in compliance." (A. 104).

The audited financial statements enabled Technimar to incur substantial additional debt and to suffer substantial additional losses. Between May 15, 1997, and December 31, 1997, Technimar incurred additional promissory note indebtedness of not less than $8,657,746, as follows:

Minneapolis Police Benevolent Fund:	$	20,000.00
Minneapolis Police Insurance		50,000.00
Minneapolis Police Relief Association-- DC		1,080,000.00
Minneapolis Police Relief Association— payroll		5,650,000.00
Rothschild Capital Corporation		1,102,746.00
Rothschild Venture & Growth		535,000.00
Judd and Anne Welliver		220,000.00

(S. R. 38).

Minutes of the board of trustees of the MPRA reflect that they were told that Technimar's audit showed that it had a $10 million net worth. (Berryman Depo., pp. 15-7; S. R. 282-3). Technimar lost approximately $14 million in 1997, and an additional $5.2 million by July 31, 1998. By the fall of 1997, Technimar's position had become perilous. It had no money to pay its remaining obligation to Breton, without which Breton would not ship the remaining equipment. New management, in the form of T. Jay Salmen, was brought in.(S.R. 473) Salmen attempted to get control of expenses and terminated most employees, particularly the various members of the Contreras family. Technimar explored a business combination with DuPont, with whose "Corian" product Stonite would compete, but after financial due diligence, DuPont withdrew from discussions. After DuPont had withdrawn from negotiations, Salmen was unable to obtain other sources of funding, and resigned.

In December 1997, the hammer fell—Heller served its notice of default and called the loan. (A. 53-55). Among the defaults were Technimar's failure to have obtained the balance of the Breton equipment and complete the project, its incurring of excess indebtedness, and its "investment in [RVG] through the purchase of Breton S.p.A's investment therein in violation of restrictions imposed by . . . Security Agreement." (A. 54) Heller exercised its rights to foreclose on the $7.6 million collateral pledge, making Technimar's earlier redemptions of Breton's investment worthless. The MPRA, by then owed in excess of $12 million by Technimar, bought out Heller's remaining position, thinking it was obtaining a security interest in the Breton Equipment and the Equipment Contract. Following Salmen's resignation, the MPRA caused Technimar to engage Coy & Associates as turnaround management, and Coy's employee, William Goblirsch, became acting C.E.O. of Technimar.

When counsel for the MPRA attempted to enforce the Heller security interest against Breton and compel delivery of the remaining equipment, Breton responded by pointing out that it was still owed substantial sums under the December Agreement, without payment of which it would not deliver the equipment. (S.R. 492).

When Goblirsch discovered the December Agreement in early 1998, he realized there were problems with Grant Thornton's audit, and brought the matter to Grant Thornton's attention. (Ravell Aff., ¶ 7, Depo., pp. 33-6, Conn Aff. Ex.J)

After internal review and analysis by counsel, Grant Thornton withdrew its audit report, by letter of April 29, 1998, to Goblirsch. (A. 121-2). [3]

Technimar filed its Chapter 11 bankruptcy on July 31, 1998, United States Bankruptcy Court, District of Minnesota, Bky. No. 98-44998. Technimar obtained secured financing in the bankruptcy case and paid off Breton to obtain delivery of the rest of the equipment; however, the attempted reorganization was unsuccessful, as Technimar was unable to pay the debt service for the loan in bankruptcy, and the new lender foreclosed and sold the equipment. The equipment was purchased by Davisco Foods International, Inc., and moved to LeSeuer, where it is now used to manufacture the Bretonstone product under the brand name "Cambria." Technimar lost its entire investment in the Breton equipment, the case was converted to a Chapter 7 liquidation on March 2, 1999, and Julia A. Christians was appointed Trustee in what was by then a no-asset case. Over $48 million in general unsecured claims have been filed in the Technimar bankruptcy case (Claims Register, Christians Aff., Ex. C), none of which have been paid.

The Litigation

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[3] Although, as indicated above, the chief problem with the audit was the mischaracterization of the $16 million "equipment deposit," and nondisclosure of the remaining obligation to Breton, neither the equipment nor Breton was mentioned in the withdrawal letter; instead, the letter made reference to supposedly undisclosed obligations to Welliver's consulting company, Rothschild Capital Corporation. The withdrawal letter stated that "Technimar should forthwith notify anyone to whom it has furnished our 1996 Audit Report that Grant Thornton has withdrawn this Report."

In the course of the bankruptcy, the Trustee obtained an order directing Grant Thornton to turn over its books and records respecting Technimar. (A.169). Based upon her investigation, including review of Grant Thornton's audit files produced in response to the bankruptcy court's order, the Trustee commenced action against Grant Thornton, contending that the audited financial statements did not fairly present Technimar's financial condition in accordance with Generally Accepted Accounting Principles, and that Grant Thornton's audit breached its contractual undertakings, was negligent, and not done in conformance with auditing standards. (Complaint, A. 2-26).

Grant Thornton denied the Trustee's allegations and asserted some nineteen affirmative defenses (Amended Answer and Counterclaim, A. 125-148). Extensive discovery followed, including review of dozens of depositions and thousands of documents produced in various other Technimar-related litigation.[4] With respect to the audit malpractice issues, each party engaged an expert, and each expert provided deposition testimony (Bateman Depo., Conn Aff. Ex. N;

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[4] Technimar's demise generated numerous lawsuits, several of which have come to the Appellate Courts. Stocke v. Berryman, 632 N.W. 2d 242 (Minn. App. 2001); Janssen v. Best & Flanagan, 662 N.W. 2d 876 (Minn. 2003); Locke Family Trust v. Bremer Trust, 2003 WL 22388719 (Minn. App. 2003); Minneapolis Police Relief Association v. Canizo, 2005 WL 1389323 (Minn. App. 2005); Davisco Foods International, Inc., v. Blackwater Prop., L.L.P., 2001 WL 641584 (Minn. App. 2001). Other Technimar-related litigation has included LaBelle v. Schirmer and Minneapolis Fire Department Relief Association (District Court, Hennepin County, Minnesota), and nine adversary actions in or related to the David Welliver bankruptcy, Bky. No. 98-34454.

Lifson Depo., Conn Aff. Ex. T, S.R. 348). In addition, the Trustee's expert provided a written report (Lifson Report, S.R. 6).

Although Grant Thornton's expert opined that the audit complied with applicable standards (Bateman Depo. p. 34, Keyes Aff. Ex. 18), the Trustee's expert expressed a contrary opinion. In the course of the litigation, the Trustee provided substantial evidence to support her claims of negligence and breach of contract, including, among others:

1. Grant Thornton's audit files contained the minutes of the September 25, 1996 "Extraordinary Meeting of the Board," (A. 48-9) but not the "Accord" [the September Agreement] between Technimar, Valent, and Breton referred to in the minutes; had Grant Thornton requested and obtained the Accord, it would have known of its provisions obligating Technimar to redeem a substantial portion of Breton's contemplated investment in Valent.

2. Grant Thornton was provided with Technimar's "subsequent events" list showing material payments to March 14, 1997, including over $1.8 million in payments to Breton after the Equipment Contract had supposedly been fully paid; Grant Thornton's audit notes show that it knew the payments were to redeem Breton's investment in Valent. (A. 109, ¶ E) Despite that violation of the Heller loan covenants, which prohibited investments in anything other than "cash equivalents," Grant Thornton issued a clean "debt compliance letter" (A. 117) and recited in its audit that Technimar was in compliance with the Heller loan covenants. (A. 104).

3. With respect to the subsequent payments to Breton, Grant Thornton traced the payments to Valent share certificates (A. 109). Although the record is not clear with respect to precisely how Grant Thornton did that, presumably its review included Breton's January 14, 1997, letter to Technimar, (Luis Contreras Depo. Ex. 5, S.R. 178).[5]

4. In connection with the Heller loan closing, there was a purported letter from Breton (faxed, and not on Breton letterhead) stating that the Heller loan proceeds would pay the full purchase price for the equipment, and "[w]e agree to promptly deliver paid invoices to you as evidence of the title transfer."[6] (Ravell Depo., Ex. 31, Conn Aff. Ex. J) Grant Thornton apparently made no effort to locate paid invoices for the equipment (Lifson Report, S.R. 10); in fact, of course, there were no paid invoices, because Breton would not have issued paid invoices until its Valent investment had been redeemed.

5. Grant Thornton sent several requests for audit confirmation to Breton, and received responses to two, one confirming that Breton was owed $8.4

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[5] In that letter, Breton stated "As foreseen by the above mentioned agreements, we hand you over, the share certificate no. 2 equal to US Dollars 1.000.000 (one million U.S. Dollars only) following the receipt of the payment of the same amount." The "above mentioned agreements" referred to in the letter's subject heading of the letter included:

> "Contract Breton/Technimar dated March 13, 1996
> Agreement Breton/Technimar/Valent Venture dated September 6, 1996 and
> <u>Agreement Breton/Technimar/Valent Venture dated December 20, 1996</u>"

(Luis Contreras Depo. Ex. 5, S.R. 178) The latter agreement, of course, is the December Agreement.

[6] Breton later claimed that the letter was a forgery; its source and true author are unknown, and there is no evidence that it was generated by Technimar.

million as of December 31, 1996, (Revell Depo. Ex. 13, Conn Aff. Ex. J) and another correcting and confirming that Breton had a $1 million stock subscription obligation to Technimar. (Revell Depo. Ex. 12, Conn Aff. Ex. J). An April 3, 1997, request for confirmation specifically requested Breton to confirm that Technimar had "a $16,000,000 deposit with you for machinery to be shipped during 1997." (Revell Depo. Ex. 11, Conn Aff. Ex. J). Grant Thornton received no response to that specific request, and made no effort to follow up with Breton.

Nearly three years after commencement of the action and after conclusion of extensive discovery, including depositions of experts, the Trustee, James Ravell, representatives of the MPRA, Heller Financial (in Chicago), and former officers, employees, and directors of Technimar (in Houston), Grant Thornton moved for summary judgment. Both parties submitted voluminous exhibits and deposition transcripts. By Order of May 12, 2006, the District Court granted (A. 177) the motion for summary judgment, and Judgment was entered May 18, 2006 (A. 195). Significantly, the Court denied summary judgment on the central issue of auditor negligence ("Taking the undisputed facts as true, the trustee has alleged a viable claim of accounting malpractice," Order, at p. 8, A. 184), and also denied summary judgment on the issue of comparative fault ("...it would also be for the jury to compare the fault, if any of Grant Thornton, to that of Technimar" (Order, at p. 13, A. 189). Despite that holding, the Court nonetheless dismissed the Trustee's action on the grounds that:

a) Technimar's deepening insolvency damages were damages to its creditors, not to Technimar, therefore concluding that the Trustee lacked standing (A. 185-6);

b) there was no causation between Grant Thornton's negligence and Technimar's damages (A. 186-7);

c) by reason of Roberto Contreras, Sr., having knowledge of the December agreement with Breton, Technimar could not have relied on the audited financial statements (A. 187-8); and,

d) the bankruptcy trustee's claims were barred on principles of in pari delicto and imputation. (A.188-9).

The Trustee timely appealed from the judgment.

Argument

A frequent question raised in reports of corporate failures with accounting problems has been "Where were the auditors?" Although nowhere near the magnitude of Enron, Global Crossing, Parmalat, and many others, the bankruptcy of Technimar Industries, Inc., with nearly $50 million in unpaid claims, does raise that question.

Technimar did have auditors, not merely outside accountants. Its auditor, Grant Thornton, LLP, issued a May 1997 audit opinion certifying Technimar's financial statements showing that Technimar had a significant equipment deposit of $16 million and a positive net worth of over $10 million. Barely seven months later, Heller had foreclosed and bankruptcy followed, with nearly $50 million in claims of unpaid creditors and many more millions in losses incurred subsequent to the audit. How could this happen, and where were the auditors?

As recognized by the District Court, at least for purposes of summary judgment, the auditors were negligent, but despite recognizing auditor negligence, the District Court nevertheless granted summary judgment to the auditors, leaving the bankruptcy estate with no means to satisfy claims of creditors.

The District Court's decision is wrong, both for its erroneous application of applicable law and in its pervasive disregard of summary judgment standards. Indeed, as will be seen, due to inescapable questions of material fact, none of the grounds upon which the Court granted summary judgment was appropriate for summary disposition.

I. A bankruptcy trustee is not deprived of standing by the fact that creditors are harmed by harm to the corporation.

In her Complaint, the Trustee alleged that "Technimar was damaged and suffered deepening insolvency which would not have occurred but for Grant Thornton's erroneous audit of Technimar's financial statements." (Complaint, ¶¶ 66, 74, A. 18, 20). In discovery, the Trustee provided detailed analyses of damages (S.R. 31, 36, 342).

The District Court found that the damages were damages to Technimar's creditors, not to Technimar: "while there are court decisions to the contrary, this court finds that the theory of deepening insolvency is not available to the trustee in this case . . . the creditors suffered the injury, not Technimar." (Order, pp. 9-10, A. 185-6).

In the absence of any decisions from this Court or the Minnesota Supreme Court to support rejection of damages for deepening insolvency, and notwithstanding Bonhiver v. Graff, 248 N.W. 2d 291, 296 (Minn. 1976), the District Court relied on Holland v. Arthur Andersen & Co., 212 Ill. App. 3d 645, 571 N.E. 2d 777 (Ill. App. 1 Dist. 1991). In that case, the sole damages for deepening insolvency asserted by the plaintiff were claims of two banks which had in fact relied on the misleading financial statements. In those circumstances, the Illinois court held that the claims were personal to the creditors, such that the bankruptcy trustee lacked standing to pursue the claims.

The present case is markedly different. The deepening insolvency suffered by Technimar involved not only unpaid obligations to particular creditors but to expenses paid and losses incurred as well (Complaint, ¶¶ 67, 75-6; A. 28-20; S.R. 32, 36, 342). In such circumstances, deepening insolvency is widely recognized as a specie of damages—see, e.g, Official Committee of Unsecured Creditors v. R. F. Lafferty & Co., 267 F. 3d 340, 347-9 (3d Cir. 2001); In re Total Containment, Inc., 335 B.R. 589 (Bankr., E. D. Pa. 2005); Schacht v. Brown, 711 F. 2d 1343 (7th Cir. 1983); Allard v. Arthur Andersen & Co., 924 F. Supp. 488 (S.D.N.Y. 1996); In re Flagship Healthcare, Inc., 269 B.R. 721, 728 (Bankr., S. D. Fla. 2001); In re

Gouiran Holdings, Inc., 165 B.R. 104 (E.D.N.Y. 1994); Smith v. Arthur Andersen LLP, 421 F. 3d 989, 1003 (9th Cir. 2005).

Contrary to Grant Thornton's assertions to the District Court, the concept of recovery for deepening insolvency has been recognized in Minnesota since 1976:

> "By his examiners' reliance upon Graff's entries, the commissioner was led to believe that American Allied was solvent, when in fact the company was insolvent. Had the examination disclosed that the company was insolvent, its continued operation would have been challenged by the commissioner.
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> * * *
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> Because of the continued operation, American Allied suffered an additional loss of $849,078.60 to the Kitzers."

Bonhiver v. Graff, 248 N.W. 2d 291, at 295, 299 (Minn. 1976) (emphasis supplied).

The District Court's holding that a bankruptcy trustee has no standing to pursue damages for deepening insolvency leads to the absurd result of a wrong (negligent audit) without a remedy, because general creditors of Technimar would be precluded from direct action against Technimar's auditor. See Noram Investment Services, Inc. v. Stirtz Bernards Boyden Surdel & Larter, P.A., 611 N.W. 2d 372 (Minn. App. 2000); TCF Banking & Sav., F.A., v. Arthur Young & Co., 706 F. Supp. 1408 (D. Minn. 1988).

Except for third parties intended by the auditors to receive the audited financial statements (here only Heller), only the client or its bankruptcy trustee has standing to sue. In National City Bank v. Coopers & Lybrand, 409 N.W. 2d 862, 868-9 (Minn. App. 1987), this Court affirmed dismissal of claims of a representative of the bankrupt's noteholders against the debtor's accountants. The Court noted that

> "[h]ere, the noteholders have not suffered a direct injury. Only in their capacity as creditors were they injured at all. Their loss is indistinguishable from the loss suffered by GCC due to the diminished value of its assets, which effect was visited on all of GCC's Chapter 11 creditors. After GCC's Chapter 11 bankruptcy petition was filed, any action against the . . . outside professionals such as C & L for diminution in the assets of the corporation . . . vested exclusively in the bankruptcy estate and could have been brought only by the debtor-in-possession or the trustee."

409 N.W. 2d 862 at 869.

The whole purpose of a Chapter 7 bankruptcy is to liquidate assets (including causes of action) and to make distribution to creditors—see 11 U.S.C. § 704 (duties of trustee) and §726 (distribution of property of the estate). A contention that benefit to creditors somehow deprives a trustee of standing fundamentally misunderstands bankruptcy law. See In re Plaza Mortgage and Finance Corp., 187 B.R. 37 (N.D. Ga. 1995); Smith v. Arthur Andersen, 421 F. 3d 989, 1004 (9th cir. 2005); Educators Group Health Trust v. Wright, 25 F. 3d

1281, 1285 (5^{th} Cir. 1994). In the latter case, the Court observed: "[T]he fact that creditors in general are harmed does not determine whether a cause of action belongs to the bankruptcy estate; rather, general harm to creditors *necessarily follows* from the fact that the debtor has been injured."

In re Senior Cottages of America LLC, 320 B.R. 895 (D. Minn. 2005), relied upon by the District Court (Order, p. 10, A. 186), is simply wrong in this regard.[7] A more recent decision, reflecting the mainstream view, is In re Bridge Information Systems, Inc., 344 B.R. 587, 593, (E.D. Mo., June 6, 2006), holding that a bankruptcy trustee has sole authority to pursue claims where, as here, injury to creditors is derivative of injury to the debtor, rather than personal to a particular creditor with no other creditor having an interest.

II. The record reflects sufficient reliance and causation to support the Trustee's claims against Grant Thornton.

The audited financial statements represented that Technimar had a positive net worth of over $10 million, and a $16 million deposit on equipment essential for its survival. Grant Thornton also issued the auditor's Debt Compliance Letter which erroneously represented that Technimar was in compliance with its loan covenants in the Heller financing. When the facts came to light seven months later, Heller promptly issued a default and foreclosed on its security. In the mean time, Technimar had incurred substantial additional debt and suffered substantial losses.

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[7] The District Court decision is currently on appeal to the Eighth Circuit, Docket No. 05-3867.

The Trustee's complaint against Grant Thornton alleges that but for the audit, Technimar would not (and could not) have incurred the damage. As discussed below, the record contains sufficient more than evidence of reliance and causation to support the Trustee's claims.

Rodney Workman, an outside director of Technimar until his resignation on November 26, 1997 (S.R.485, 487), signed off on numerous resolutions subsequent to the audited financial statements, including resolutions authorizing issuance of additional stock (S.R. 472), and employment agreements (S.R. 483). In his deposition, Workman confirmed the accuracy of his answers to interrogatories in a previous action in which he stated that he "relied on financial documents that were presented to him, and other Board of Directors members, by Roberto Contreras, Sr., during various meetings of the Board of Directors." (Workman Depo., pp. 16-17, and Exhibit 1, p. 4, S.R. 265). The internal financial statements prepared subsequent to the audit by Technimar's controller, Carlos Canales, were based upon the audited financial statements. (Canales Depo. p. 34, S.R. 115). His internal financial statements generated monthly during 1997 (Canales Ex. 4 - 13, Keyes Aff. Ex. 43) accordingly were consistent with the Grant Thornton audited statements, and incorporated what are alleged to have been the errors in the audit, primarily the equipment deposit and omission of the Breton repurchase obligation.

Luis Contreras, as Chief Financial Officer of Technimar, testified that he believed the Grant Thornton audited financial statements and subsequent internal statements to be accurate, and relied on the audit report in the conduct of Technimar's business (Luis Contreras Depo., pp.12-13 and Contreras Depo Ex. 1; S.R. 137, 149). As CFO, he was cooperative with Grant Thornton in the audit (Ravell Depo. pp. 48-9), and he signed each of the requests for confirmation to Breton (A. 84, 85, 120), including the April 3, 1997, request for confirmation that Technimar had a $16 million deposit on the equipment (A. 84). As CFO, he signed the promissory notes to the MPRA (Luis Contreras Depo., at p.7, S.R. 136). The audited financial statements were provided to the MPRA (Id., at p. 9, S.R. 136).

Allen Berryman was a trustee and Secretary for the Board of Trustees of the Minneapolis Police Relief Association (Berryman Depo., pp. 7-8; Conn Aff. Ex. L, S.R. 280). He was also a director of Technimar during 1997 until his resignation November 13, 1997 (Christians Aff., Ex. N, S.R. 488). He testified to having seen the audit showing Technimar assets exceeding liabilities by $10 million (Berryman Depo., pp. 15-17, S.R. 282-3). In November 1997, Berryman, on behalf of the MPRA, demanded payment, and in December 1997, he instructed Welliver to "make no further investments of MPRA assets in Technimar notes, bonds, or other instruments." (Berryman Depo. pp. 13-15, S.R. 282). Berryman testified that if he had known earlier that the supposed $10 million of equity in Technimar assets over liabilities was not there, he would have taken action earlier. (Berryman Depo., pp. 22-3, S. R. 284).

Rodney Workman testified that if it had come to his attention that the company's financial statements were not accurate, he "would have done everything I could to get it rectified." (Workman Depo., pp. 18-23; Conn Aff. Ex. K, S.R. 266). Charles Foster, another outside director and a lawyer, similarly testified that he would have sought immediate action to address the problem. (Foster Depo., pp. 20-22, 40-41; Conn Aff. Ex. M, S.R. 307-8, 312).

If Grant Thornton's audited financial statements had reflected Technimar's true situation, much damage would have been avoided. The already major creditors such as MPRA could have forced management change much earlier than they ultimately did. Work-out discussions with Heller and other major creditors could have commenced, and, failing resolution, bankruptcy protection could have been had at a time when success was possible. The Heller foreclosure could have been stayed, under 11 U.S.C. § 362. The avalanche of loans from the police and fire pension funds would not have happened. Even short of a successful reorganization, there was value in the company, and in bankruptcy, Technimar's interest in the Breton contract could have been assumed and assigned under 11 U.S.C. § 365 (f), permitting some recovery of Technimar's $9 million-plus investment in that contract. "In the world of corporate workouts, turnaround managers and the possibility for a quick change in an economic tide, it is not uncommon for a corporation to revitalize itself and work out financial problems no matter how dire they appear," In re Flagship Healthcare, Inc., 269 B. R. 721 (Bankr., S. D. Fla. 2001) (recognizing claim for deepening insolvency against financial advisor).

III. The Court erred in granting summary judgment on issues of imputation and in pari delicto.

Among Grant Thornton's nineteen affirmative defenses (Amended Answer, ¶¶ 97 - 115, A. 133-35) were assertions that the Trustee's claims are barred on principles of comparative fault, in pari delicto, and imputation.

The District Court denied summary judgment on the issue of comparative fault (A. 189) but granted summary judgment on the in pari delicto defense (A. 188). But, as the District Court recognized, in pari delicto is based on the proposition that "[e]quity precludes one wrongdoer from suing another who is equally at fault" (emphasis supplied), citing State v. AAMCO Automatic Transmissions, Inc., 293 Minn. 342, 199 N.W. 2d 444 (Minn. 1972).

Accordingly, to find for Grant Thornton on the in pari delicto defense, the District Court must necessarily have concluded that the parties had equal fault, an exercise that the Court properly declined with respect to the comparative fault claim.

In Halla Nursery, Inc., v. Burmann-Furrie & Co., 454 N. W. 2d 905 (Minn. 1990), the Supreme Court applied comparative fault in an action for accounting (not auditing) negligence, and the Court noted:

> "We recognize, however, that professional malpractice actions pose peculiar problems and that the comparison of fault between a layperson and a professional should be approached with caution."

454 N.W. 2d at 909 (emphasis supplied).

Comparison of fault, whether for purposes of determining contributory negligence, comparative fault, or in pari delicto, is a factual inquiry, not readily suited for summary judgment. That proposition is demonstrated in this case by a review of the record, and a comparison of the respective conduct of Grant Thornton and Technimar.

Technimar's personnel interviewed several firms to audit its financial statements (Canales Depo. pp. 20-22, S.R. 111). Grant Thornton represented that it specialized in serving middle-market manufacturing companies, and that it was "recognized by the investment and financial community as a highly-qualified, reputable national accounting firm serving middle-market and publicly held companies." (Grant Thornton August 9, 1996, letter, A. 56). In its engagement letter, Grant Thornton agreed that its "audit will be conducted in accordance with generally accepted auditing standards." (Grant Thornton December 9, 1996, letter, A. 77).

On or about May 15, 1997, Grant Thornton issued its audit report and audited financial statements to Technimar's Board of Directors (A. 86-106). Grant Thornton gave an unqualified opinion that the financial statements attached to its audit opinion "present fairly, in all material respects, the consolidated financial position of Technimar Industries, Inc. and subsidiaries as of December 31, 1996, . . . in conformity with generally accepted accounting principles." Its report represented that "[w]e conducted our audit in accordance with generally accepted auditing standards." (A. 88).

The audited financial statements reflected that Technimar's assets exceeded its liabilities by $10,005,208. The primary asset listed was $16 million in deposits on machinery and equipment. Nothing in the financial statements or accompanying notes reflected any contingency or uncertainty regarding delivery of the Breton equipment, nothing respecting any obligation of Technimar to redeem Breton's $7.6 million deposit to secure payment of the Heller bond, and recited that a "security agreement between the purchaser of the bond and the Company contains certain restrictive covenants, for which the Company is in compliance."

Plaintiff's expert, Todd Lifson of Lurie, Besikof, Lapidus & Company, LLP, in addition to his deposition testimony, has issued a detailed expert's report (Conn Aff., Ex. A, S.R. 8). His opinion is that Grant Thornton's "audit of Technimar's 1996 financial statements did not present fairly in all material respects the consolidated financial position of Technimar as of December 31, 1996, in conformity with GAAP. In addition, it is my opinion that Grant did not conduct its audit in a manner consistent with GAAS."

Even without expert opinion, normal lay people can see the problems with Grant Thornton's audit. The single most important factor for Technimar to commence its manufacturing operations was the Breton equipment; obtaining the equipment was the sine qua non for its survival. Its previous auditor had noted as much, observing the "significant uncertainty" in Technimar's ability to pay for the equipment. (Zissa audit, A. 43; Lifson Report, p. 17, S.R. 24).

By the time of Grant Thornton's audit, Breton had supposedly been paid the balance on the equipment contract through the Heller bond financing, although it was known that $7.6 million of the proceeds were on deposit to secure the Heller bond (audited financial statement, note I, p.17, A. 104). But, for some reason, Technimar was still making substantial payments to Breton in early 1997--$1.8 million by March 14, 1997, and another $800,000 by the time the audit report was issued. (Lifson report, p. 11, S. R. 18; Breton answer to interrogatory 14 in <u>Christians v. Breton</u>, Conn Aff., Ex.R, S.R. 341). The obvious question for an <u>auditor</u> was why? If Breton had been fully paid for the equipment, why was Technimar paying additional millions to Breton? Technimar <u>did not conceal</u> the payments, and Grant Thornton was informed and understood that Technimar was buying out Breton's position on the deposit securing the Heller loan.

But the question still was why? For an <u>auditor</u>, the most obvious solution would be "ask Breton." Grant Thornton did so, sort of. It sent (or had sent by Technimar) a request for confirmation of Breton's $1 million stock subscription, an obligation reflected in the September Agreement (A. 44). Breton replied, confirming the obligation but correcting the amount of its obligation to purchase the preferred shares involved (Ravell Depo., Ex. 12; Conn Aff. Ex. J). Grant Thornton sent a request, apparently on March 18, 1997, for confirmation of amounts owing on notes and otherwise (A. 120). Breton again replied stating that it was owed some amount (apparently $192,097) on an installment note, and that it was owed $ 8.4 million on the equipment contract (A. 107-8) (Ravell Depo., Ex. 13; Christians Aff., Ex. R, S. R. 489).

In light of Breton's claim that it was owed $ 8.4 million on the equipment contract, despite having apparently been paid in the Heller transaction, it would be obvious for the auditor to ask "do we have a $16 million deposit on equipment or not?" A document asking precisely that was prepared—see April 3, 1997, Request for Confirmation, signed by Luis Contreras (A.84) (Ravell Depo. Ex. 11, Conn Aff. Ex. J):

> "For purposes of verification in connection with an audit, will you please confirm to our auditors, Grant Thornton, 500 Pillsbury Center, Minneapolis, MN 55402 whether or not we have a $16,000,000 deposit with you for machinery to be shipped during 1997."

Grant Thornton's (now former) employee Susan Duerre prepared a fax cover sheet to be sent directly to Breton by Grant Thornton (Ravell Depo., Ex. 11, GT000825). Either Breton did not reply or the request for confirmation was never sent by Grant Thornton; in either case, Grant Thornton received no confirmation from Breton that Technimar had a $ 16 million deposit for machinery to be shipped in 1997.

Notwithstanding the absence of confirmation from Breton, there was yet another way for the auditors to have ascertained whether the equipment deposit had been paid, which also was not done by Grant Thornton. The auditors had access to the entire closing file from the Heller loan transaction (Ravell Depo., p. 77; Conn Aff. Ex. J). A faxed December 27, 1996, letter therein, purportedly from Breton, stated:

> "Finally, we acknowledge that upon completion of these wire transfers, Technimar Industries, Inc., shall have paid the full purchase price for the Equipment and agree that title to the Equipment shall transfer to you. We agree to promptly deliver paid invoices to you as evidence of the title transfer and we will hold the Equipment for your benefit pending our receipt of shipping instructions from you."

Ravell Depo., Ex. 31, Conn Aff. Ex. J) (emphasis supplied).

If, as Grant Thornton concluded, Breton had been fully paid for the equipment from the Heller proceeds, there should have been "paid invoices . . . as evidence of the title transfer." There were none, of course, but Grant Thornton never asked. In the circumstances, to any reasonable person, that failure was negligent, and as set forth in detail in the Lifson report, the audit was not done in a manner consistent with Generally Accepted Auditing Standards, and, as a result, the audited financial statements did not comply with either Generally Accepted Accounting Principles or Grant Thornton's contractual commitment to Technimar (Engagement letter, A. 77).

The record thus contains clear grounds upon which to conclude that Grant Thornton's audit was negligent and did not fulfill its contractual undertakings, and the question then becomes was there sufficient fraudulent or negligent conduct by Technimar to support a finding of <u>equal</u> fault to establish the <u>in pari delicto</u> affirmative defense?

In its summary judgment motion, Grant Thornton repeatedly sought to characterize Technimar as a "fraudulent debtor," claiming that it defrauded the participants in the Heller bond transaction, and that it fraudulently misrepresented matters to Grant Thornton. The District Court, however, made no finding of fraud, and, on the record before it, could not, because Grant Thornton did not establish facts to support the fraud claim. <u>Hanson v. Ford Motor Company</u>, 278 F. 2d 586 (8th Cir. 1960), sets forth the elements of fraud in Minnesota:

1. There must be a representation;
2. That representation must be false;
3. It must have to do with a past or present fact;
4. That fact must be material;
5. It must be susceptible of knowledge;
6. The representer must know it to be false, or in the alternative, must assert is as of his own knowledge without knowing whether it is true or false;
7. The representer must intend to have the other person induced to act, or justified in acting upon it;
8. That person must be so induced to act or so justified in acting;
9. That person's action must be in reliance upon the representation;

10. That person must suffer damage;

11. That damage must be attributable to the misrepresentation, that is, the statement must be the proximate cause of injury.

The elements necessary for a finding of fraud simply are not present in this case, and, despite Grant Thornton's urging, the District Court found no "fraud" on the part of Technimar. The District Court based its finding of in pari delicto not on fraud but on the proposition that "both Roberto and Luis knew that the Breton equipment purchase agreement was not properly disclosed to anyone." (Order, p. 12, A.188). There is no evidence in the record that the December Agreement was intentionally withheld or other wise concealed, and Technimar in fact provided documentation concerning the September Agreement, as well as records of payments required by the December Agreement.

Despite its repeated assertions of having somehow been misled by Technimar in connection with the audit, Grant Thornton produced no evidence that Technimar misled it in connection with the audit. Jim Ravell, the partner in charge, has admitted that the Technimar employees primarily involved in the audit were cooperative (Ravell Depo., pp.48-9, Conn Aff. Ex. J), and he identified no misrepresentations by either of them. He knows of no board minutes not provided. The September 25 minutes of the "extraordinary" board meeting provided to Grant Thornton made reference to the September accord with Breton and Valent (indeed, that was the only subject of the extraordinary board meeting) but there is no indication that Grant Thornton made any effort to obtain the material referred to, or even asked for it; the affidavits of its former employees were significantly silent on this subject. Although Grant Thornton contends that Roberto Contreras, Sr., in essence ran the company with no oversight or control from the directors, no one at Grant Thornton bothered to talk to Roberto Contreras, Sr., about the status of the Breton contract, even though the September 25 board minutes made clear that he was the point-man in the Breton relationship. Roberto Contreras, Sr., if Grant Thornton had bothered to ask, presumably could have answered questions regarding Technimar's redemption of Breton's RVG shares as Technimar provided to Grant Thornton, but he has testified that he had no role in providing information for the audit:

> "Q. Did you have any role in providing information for that audit?
>
> "A. No. I had the role just review and revise the, the final thing if I got any comment about that. I'm not an accountant, it's very difficult."

(R. Contreras, Sr., Depo. in Stocke v. Berryman, pp 84-5, S.R. 200-201).

Technimar fully disclosed its post-closing payments to Breton to redeem the RVG investment, and Ravell understood that Technimar was taking over Breton's position with respect to the $7.6 million that had been pledged to secure the Heller loan—see Ravell deposition, pp.52-56, 101-04, Conn Aff., Ex. J). Technimar also provided the January 14, 1997, letter from Breton specifically including the Equipment Contract, the September Agreement, and The December Agreement as its subject matter. (Luis Contreras Depo. Ex. 5, S.R. 178)

Grant Thornton also claimed that it was somehow defrauded or misled by the execution of Grant Thornton's "representation letter" at the conclusion of the audit. The letter was signed by Roberto Contreras, Sr., Luis Contreras, and Carlos Canales.

It must first be remembered that an auditor's "representation letter" from its client that all requested information has been provided is not a substitute for audit work, but merely an added level of comfort—See Lifson Expert Report at p.18, n. 21, S.R. 25).

Second, both Luis Contreras and Carlos Canales have testified to their belief that their signing the representation letter was honest and accurate (L. Contreras Depo., pp. 10-11, S.R. 137, Conn Aff. Ex. H; Canales Depo., pp. 29-31, S.R.113-4, Conn Aff. Ex. G). Roberto Contreras, Sr., has not been deposed in this action, but was not involved in the audit process.(Contreras, Sr., Depo., pp. 84-5,Conn Aff. Ex. I, S. R. 200-01).

Third, the representation letter is effectively boiler-plate, prepared by the auditor, not the client--sign it if you want your audit report. In the present case, Grant Thornton prepared the representation letter and submitted it to Technimar in a meeting at Technimar's offices. (Ravell Depo., pp.110-120, Conn Aff. Ex.J). Many of the provisions of the representation letter (Keyes Aff. Ex. 61) involve technical accounting issues respecting which a non-professional would have no way of knowing whether the representations requested are accurate, for example:

- "There have been no irregularities involving management . . . or other employees . . ."
- "We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities. No provision is necessary for impairment of long-lived or intangible assets."
- "There are no:

    a. violations or possible violations of laws or regulations . . ;

    b. other material liabilities or gain or loss contingencies that are required to be accrued or disclosed by Statement of Accounting Standards No. 5."

Grant Thornton asserted that signing the letter was a lie or a fraud on the part of the Technimar personnel by not disclosing the Breton repurchase commitment. In his deposition, Mr. Ravell, the Grant Thornton partner in charge of the Technimar audit, was asked:

> Q. Well, I guess what I'm getting at is what in the representation letter, Exhibit 21, is a false representation to Grant Thornton?
>
> Mr. Keyes: Are you asking now with respect to the Rothschild or—
>
> Mr. Conn: Anything.
>
> Mr. Keyes: Anything overall?
>
> The Witness: Well, I think relating specifically to the Rothschild matter, I think in item 8(b), as in boy, it talks about other material liabilities that are required to be accrued or disclosed by FAS 5. So I think we viewed, you

know, the information that we were receiving from Bill [Goblirsch] as potential other material liabilities that needed to be accrued for.

By Mr. Conn:

Q. And this relates to Rothschild or to what?

A. Specifically this relates to Rothschild.

(Ravell Depo., pp. 114-115). Significantly, contrary to what Grant Thornton now claims was Technimar's "fraud" in signing the representation letter, Ravell <u>made no reference</u> to the Breton situation, despite his counsel's prompting him to answer with respect to "anything overall." Mr. Ravell's response was honest, because Grant Thornton knew full well that Technimar was buying out Breton's position in the RVG securities pledged to Heller. (Grant Thornton audit notes, A. 109).

If Grant Thornton had simply done its job, <u>e.g.</u>, by contacting Breton to confirm the equipment deposit, and requesting paid invoices, any failure by Technimar to provide the December Agreement or anything else would not have mattered. Under these circumstances, the District Court's implicit finding of equal fault to support its <u>in pari delicto</u> conclusion is simply error.

The facts in the record do not provide a basis for summary judgment finding Technimar <u>in pari delicto</u> with Grant Thornton's negligence. The doctrine of <u>in pari delicto</u> is an equitable doctrine which generally holds that where two parties bear equal guilt (generally, of a criminal or other illegal nature), equity will not permit one to recover against the other.

It is true that there is a division of authority around the country regarding whether a bankruptcy trustee may be subject at all to in pari delicto and similar defenses based upon alleged wrongdoing of corporate officers prior to the bankruptcy. Compare In re Total Containment, Inc., 2005 WL 3475716 (Bankr. E. D. Pa.) and In re Meridian Asset Management, Inc., 296 B.R. 243 (Bankr. N. D. Fla. 2003) with In re Adelphia Communications Corp., 330 B.R. 364, 377-81 (Bankr. E. D. N.Y. 2005) and In re Fuzion Technologies Group, Inc., 332 B.R. 225 (Bankr. S.D. Fla. 2005) (in pari delicto defense does not apply to the bankruptcy trustee, as a matter of law).

Courts have long recognized that the applicability of the in pari delicto defense (an equitable doctrine, after all) may depend on public policy considerations and whether application of the doctrine serves important public purposes. The United States Supreme Court has twice rejected the defense for those reasons. In Perma Life Mufflers, Inc., v. International Parts Corp., 392 U.S. 134, 88 S. Ct. 1981, 20 L. Ed. 2d 982 (1968), the Court held that in pari delicto was not a bar in a private antitrust action, noting "the inappropriateness of invoking broad common-law barriers to relief where a private suit serves important public purposes," 392 U.S. at 137). Similarly, in Bateman Eichler, Hill Richards, Incorporated, v. Berner, 472 U.S. 299, 105 S. Ct. 2622, 86 L. Ed. 2d 215 (1985), the Court held the defense inapplicable in the context of a private action for violation of federal securities laws, noting that historically "the public policy considerations that undergirded the *in pari delicto* defense were frequently construed as precluding the defense even where the plaintiff bore substantial fault for his injury," 472 U.S. at 306.

The applicability of the defense, along with similar equitable defenses of imputation, unclean hands, and the like, is a matter of state law, even where the plaintiff is a bankruptcy estate established under Federal bankruptcy law. Waslow v. Grant Thornton, LLP (In re Jack Greenberg, Inc.), 240 B.R. 486, 501 (Bankr., E. D. Pa. 1999) ("In pari delicto is an affirmative defense, as to which, like all affirmative defenses, defendants bear the burden of persuasion.") Bondi v. Citigroup, Inc., 2005 WL 975856 at *14 (Superior Court of N.J., 2005) (Keyes Aff. Ex. 73); In re Adelphia Communications, Inc., 330 B.R. 364, 378-81 and n. 50 (Bankr. S.D.N.Y. 2005).

Minnesota case law respecting the in pari delicto doctrine has generally involved either efforts to enforce an illegal contract, e.g., State v. AAMCO Automotive Transmissions, Inc., 199 N.W. 2d 444,448 (Minn. 1972); Brubaker v. Hi-Banks Resort Corp., 415 N.W. 2d 680, 683 (Minn. App. 1987), or claims for indemnity or contribution between joint tortfeasors. Neither the Minnesota Supreme Court nor this Court has ruled on whether and under what circumstances in pari delicto may defeat a claim by a bankruptcy trustee based upon pre-bankruptcy conduct of an officer of the bankrupt. It is instructive, however, that similar defenses based on claims of wrongdoing or fraud by corporate officers have been rejected by the Minnesota Supreme Court in actions brought by receivers. Bonhiver v. Graff, 248 N.W. 2d 291, 296 (Minn. 1976); Magnusson v.

American Allied Ins. Co., 189 N.W. 2d 28, 33 (Minn. 1971); German-Am. Finance Corp. v. Merchants & Mfgrs. Bank, 225 N.W. 891 (Minn.1929). The approach of the Minnesota Supreme Court is consistent with that of the U. S. Supreme Court in Perma Life Mufflers and Bateman Eichler, and reflects a practical view of the realities of the case, rather than a blind adherence to an abstract legal concept.

Regardless of whether a bankruptcy trustee may be subject to the in pari delicto defense based upon prior acts of corporate officers, in the present case, Grant Thornton did not meet its burden to establish the affirmative defense, particularly on summary judgment. Virtually every case in which an in pari delicto defense has been allowed against a bankruptcy trustee has involved situations of massive fraud perpetrated by the corporate officers or shareholders or the corporation itself. For example, Grant Thornton cited In re Advanced RISC Corp., 324 B.R. 10 (D. Mass. 2005) as a case granting summary judgment against a trustee's claims. In that case, the corporation itself had been created "to defraud creditors through bogus leasing contracts," and its principals had been convicted on federal criminal charges. The Court there had previously observed that "[a]ll of the officers of the Debtor corporation were involved in the underlying fraud," 317 B.R. 455, 457. Similarly, in MCA Financial Corporation v. Grant Thornton, LLP, 687 N.W. 2d 850 (Mich. App. 2004) (applying Michigan law), the corporate officers had been convicted for securities fraud on the order of $200 million. In Official Committee of Unsecured Creditors v. R. F. Lafferty & Co., Inc., 267 f. 3d

340 (3d Cir. 2001), the Court, although recognizing "deepening insolvency" as an independent tort, held over dissent that in pari delicto barred the Committee's claims. In that case, the debtor corporation had been run as a fraudulent Ponzi scheme by insiders whose fault was imputed to the bankruptcy creditors committee for purposes of applying in pari delicto. See also Laddin v. Edwards (In re PSA, Inc.), 437 F 3d 1145 (11th Cir. 2006) ("massive Ponzi scheme;" sole owner indicted and convicted).

Nothing even remotely similar exists in the case at hand. Technimar was a legitimate business, not a Ponzi scheme, and not a criminal enterprise. No one has gone to jail. As discussed previously, the December 20, 1996, modification agreement entered into by Roberto Contreras, Sr., does not rise to the level of fraud; pursuant to that agreement, Technimar undertook to purchase Breton's investment in the RVG shares, something that the other obligors and guarantors in the bond transaction knew all along was intended, and the purchases were not concealed from Grant Thornton; there is no fraud or wrongdoing which can trigger application of the in pari delicto doctrine.

The District Court also based its summary judgment on grounds of imputation, stating: [w]hat is undisputed is that both Roberto and Luis knew that the Breton equipment purchase agreement was not properly disclosed to anyone. This fact is imputed to Technimar and the trustee . . . [n]either can claim detrimental reliance on the Grant Thornton audited financials because they failed to properly account for that purchase." (Order, p. 12, A. 171).

There are several problems with this finding and conclusion. First, there is no evidence in the record that both Roberto and Luis knew that the Breton equipment purchase agreement was not "properly" disclosed to anyone. Rather, the basic Breton equipment purchase agreement was provided to Grant Thornton, as were the minutes of the "extraordinary" board meeting of Technimar regarding the September Agreement (A. 48). Further provided were Technimar's records of payments in 1997 to Breton to redeem its Valent investment, transactions prohibited under the Heller financing. In tracing the payments, Grant Thornton presumably had access to Technimar's correspondence from Breton acknowledging a $1 million redemption, specifically referring to the December Agreement (Luis Contreras Depo. Ex. 5, S.R. 178).

Grant Thornton did not obtain the December Agreement, and the record does not reflect where the document was kept. Luis Contreras, the Chief Financial Officer, testified that he did not learn of the December supplemental agreement until sometime later (L. Contreras Depo., pp. 14-17, S.R.138).

The December Agreement was in Italian, and in his deposition, Luis Contreras did not recall ever having seen an English translation (L. Contreras Depo., p.16, S.R 138). It appears that the December Agreement was not translated until January 2000—see Keyes Aff., Ex. 22, at p.TR012355).

There is no basis for the assertion that the document was kept "hidden." Until January 2000, there was no English translation of the agreement. Roberto Contreras, Sr., if Grant Thornton had bothered to ask, presumably could have answered questions regarding Technimar's redemption of Breton's RVG shares and the "Agreement Breton/Technimar/Valent Venture dated December 20, 1996" referred to in the January 14, 1997, Breton letter (L. Contreras Depo. Ex. 5, S.R. 178), but Mr. Contreras has testified that he had no role in providing information for the audit. (R. Contreras, Sr., Depo. in Stocke v. Berryman, pp 84-5; S.R. 200-201).

James Ravell, Grant Thornton's partner in charge of the Technimar audit, testified that Carlos Canales and Luis Contreras were generally cooperative in the audit process, and that the only discussions he recalled with Roberto Contreras, Sr., related to the company's future strategy and plans, not the status of the Breton contract. (Ravell Depo., pp.48-9; Conn Aff. Ex. J). He also testified that there were no discussions with Roberto, Sr., regarding the "representation letter" (Keyes Aff. Ex. 49,) and no discussions with him about liabilities required to be disclosed (Ravell Depo., pp. 117-18, Conn. Aff. Ex. J).

The District Court held that knowledge of Roberto Contreras, Sr., must be imputed to the corporation, in essence recycling its in pari delicto conclusion. But the critical question to be addressed is what knowledge is imputed and to what effect?

In cases of accounting or auditing malpractice, imputation may provide a defense where the corporation, through its officers, imputedly knows the audit to be wrong, thereby negating reliance. The seminal case in this area is Cenco Incorporated v. Seidman & Seidman, 686 F. 2d 449 (7th Cir. 1982). Cenco's top management had engaged in a "massive fraud," and after the fraud was discovered, Cenco sued its auditors for not catching it earlier. Cenco's claim against the auditors was brought by Cenco itself, not by a receiver and not by a bankruptcy trustee. In affirming dismissal of the claim, the Court noted that recovery from the auditors would benefit the corrupt officers and shareholders.

In this case, of course, unlike in Cenco, any recovery will go to the bankruptcy estate, for the benefit of creditors, not for the benefit of corporate officers and shareholders.[8] Cenco stands for the proposition that if by imputation, a corporation is deemed to know that a financial statement is wrong, it cannot have relied upon it. But the problem is imputed knowledge of a fact is not necessarily the same as knowledge that a financial statement does not present the company's financial condition in accordance with Generally Accepted Accounting Principles. The Federal District Court's discussion in FDIC v. Deloitte & Touche, 834 F. Supp. 1129 (E. D. Ark. 1992), is instructive:

> Undoubtedly, the individuals at FirstSouth conducting the transactions described in the Complaint knew what they were doing. The Court accepts the FDIC's argument, however, that knowledge of particular transactions is not necessarily the same thing as knowledge of the thrift's overall financial condition. . . . Even if a single individual perpetrated each of FirstSouth's many wrongs, that person may not have

[8] The Contreras family members, in settlement of prior actions brought by the Trustee, waived any claims against the bankruptcy estate, Luis Contreras Depo., p. 5, S.R. 135; Roberto Contreras, Jr., Depo., p. 4, S.R. 444).

> known the aggregate effect of his actions on the thrift's well-being. Moreover, a person might know the general effect of a given act without being aware of exactly how the act has harmed or helped his company. For example, an officer who arranges to park a problem loan will know that the deal will create an inaccurate impression of higher profits and lower reserve requirements. That general understanding could be enough to motivate the officer's actions. Accountants discovering and reporting the transaction, however, could inform the officer of precisely how inaccurate of an impression he had created.
>
> <u>Thus, even if the knowledge of every FirstSouth employee involved in the events that caused the thrift's losses is imputed to FirstSouth, a possibility remains that DH & S's audits communicated new information to its client--or at least would have communicated new information if they had been competently done.</u>

834 F. Supp. at 1137. (emphasis supplied).

Although Roberto Contreras, Sr., certainly knew of the December modification to the earlier agreements with Breton, that knowledge does not equate to knowledge that the Grant Thornton audited financial statements were in error. This is illustrated by the fact that Luis Contreras, Technimar's Chief Financial Officer, believed (even after learning of the December Agreement with Breton) that both the audited financial statements and subsequent internal financial statements accurately reflected the financial condition of Technimar (Luis

Contreras Depo., pp. 11-12, S.R. 43). Indeed, as late as April 3, 1997, long after he supposedly knew (something) of the December Agreement, he signed the auditor's request for confirmation to Breton that Technimar had a $16 million equipment deposit. That fact is consistent with his sworn belief that the audited financial statements were accurate, and is also consistent with the proposition that he was not concealing information from Grant Thornton; if Grant Thornton had only followed through with Breton on the confirmation request signed by Luis, its audit opinion would or should have been much different. The negligence was Grant Thornton's, not any wrongdoing by Technimar personnel.

The District Court inferred that because Roberto, Sr., had knowledge of the December Agreement, Technimar management must have known that the audited financial statements were wrong. But knowledge of a fact by a non-accountant is not the same as knowledge that a financial statement is inaccurate; this rather obvious premise is demonstrated in testimony by Grant Thornton's expert, Steven Bateman. In his deposition, Mr. Bateman agreed that Technimar's Breton repurchase commitment should have been reflected in the audited financial statements, but he was unable to say where, how, or as what:

> Q Did the audited financial statements accurately reflect the financial condition of Technimar Industries?
>
> A Now we're crossing over into GAAP as opposed to GAAS. With the possible exception of the disclosure of a contingent liability, I believe the statements did reflect the financial condition.

Q What contingent liability?

A Apparently there was an agreement entered into between the company, Breton, and Welliver where the company committed to buy certain investments that Breton had made in the Rothschild Fund.

Q Why do you call it a contingent liability?

A It was a commitment. Maybe contingent liability isn't the right word. Maybe commitment to purchase those is the right terminology.

Q Is obligation synonymous with commitment?

A I think in an English sense they are synonyms, terms of art in accounting, obligation, commitment, liability. They may be interchangeable with certain nuances depending on the circumstances. How they would be accounted for, again, would depend on the particular facts and circumstances.

Q Should that have been on the financial statement?

MR. KEYES: Objection, vague. you're asking should they have found it or had they found it, how it should have been accounted for?

BY MR. CONN:

Q I'm asking should this contingent liability, commitment, whatever we call it, have been on the financial statement?

MR. KEYES: Object to the question as vague.

THE WITNESS: I haven't completely formulated my thinking on that but I would, sitting here today, I would say that that obligation or that commitment was probably something that should have been disclosed in the December '96 financial statements but probably not accounted for. There may be alternative ways of accounting or treating that obligation in terms of grossing up the balance sheet but I haven't completely fleshed that out, if you will.

BY MR. CONN:

Q I understand that there could have been different alternative ways that it would be presented. Number one, it could have been listed as a liability on the statement itself, correct?

A That's a possibility. But as I sit here today, I don't think that would be appropriate or preferable method.

Q Or it might have been footnoted someplace, correct?

A Disclosed as a commitment, that's, as I sit here today, that's where my thinking is leading me.

Q Does that commitment impact the accuracy of having listed a 16 million-dollar deposit on equipment?

A Again, my views on the GAAP presentation aren't completely formed, but I don't believe that that commitment directly runs to the16 million-dollar deposit. The circumstances are all intertwined, but I believe, as I sit here today, the deposit asset stands on its own and then there's an additional obligation created by that other agreement.

Q If delivery of the equipment is contingent upon performance of the other agreement, does that not affect the way the equipment deposit should be treated?

A Again, with the same qualification I don't, as I sit here today, I don't believe so. The money for the deposit was in fact paid as I understand the facts.

Bateman Depo., pp. 25-28; Conn Aff., Ex. N).

If an accounting and auditing expert from a Big-Four Accounting firm (PriceWatershouseCoopers) charging $495 per hour only vaguely says that the Breton repurchase arrangement should have been reflected in the audited financial statements, but does not know how, where, or as what it should have been reflected, it is illogical and bizarre to conclude that Technimar management by imputation knew the audited financial statements were wrong, and therefore could not have relied upon the audit. The testimony of Technimar's Chief Financial Officer is directly contrary to that conclusion.

IV. The District Court's decision failed to follow established standards for summary judgment.

Summary judgment is properly granted only when no genuine issues of material fact exist and either party is entitled to judgment as a matter of law. Minn. R. Civ. P. 56.03; Vlahos v. R&I Construction of Bloomington, Inc., 676 N.W.2d 672, 676-77 (Minn. 2004). Summary judgment is an extraordinary remedy, a blunt instrument to be used only where it is clearly applicable. Katzner

v. Kelleher Construction, 535 N.W.2d 825, 828 (Minn. Ct. App. 1995). It should be employed only where it is perfectly clear that no issue of fact is involved and it is not necessary to inquire further into facts which might clarify application of the law. Woody v. Krueger, 374 N.W.2d 822, 824 (Minn. Ct. App. 1985). Because summary judgment is not intended as a substitute for trial when there are factual issues to be determined, the court's function is not to weigh evidence or decide issues of fact but to determine whether there are issues to be tried. State by Hatch v. Allina Health System, 679 N.W.2d 400, 406 (Minn. Ct. App. 2004); Naegele Outdoor Advertising Co. of Minneapolis v. City of Lakeville, 532 N.W.2d 249, 252 (Minn. Ct. App. 1995); Simonson Cashway Co. Inc. v. Merickel Construction Co., Inc., 391 N.W.2d 903, 905 (Minn. Ct. App. 1986). The trial court must view the evidence in the light most favorable to the nonmoving party. Woody, 374 N.W.2d at 824. All doubts and inferences must be made in favor of the nonmoving party. Simonson Cashway, 391 N.W.2d at 905.

On appeal from a grant of summary judgment, the Court of Appeals must determine whether any genuine issues of material fact exist and whether the trial court erred in its application of the law. Vlahos, 676 N.W.2d at 677; Katzner, 535 N.W.2d at 828. The evidence must be viewed in the light most favorable to the party against whom judgment was entered. Vlahos, 676 N.W.2d at 677; Kersten v. Minnesota Mutual Life Insurance Co., 594 N.W.2d 263, 266 (Minn. Ct. App. 1999). The determination of whether a genuine issue of material fact exists is subject to de novo review. Meintsma v. Loram Maintenance of Way Inc., 684 N.W.2d 434, 438 (Minn. 2004).

While trial courts quite properly are not as leery of granting summary judgment as was the case years ago, the basic rules and standards remain the same—the court may not find facts where there is a dispute, and evidence, including inferences therefrom, must be viewed in favor of the non-moving party. In this case, the District Court seriously deviated from those standards.

The District Court found that "Technimar knew they [the financial statements certified by Grant Thornton] were incorrect." (Order, p.12, A. 189). This finding is directly contradicted by the testimony of Technimar's Chief Financial Officer, who testified that he believed the Grant Thornton audited financial statements and subsequent internal statements to be accurate, and relied on the audit report in the conduct of Technimar's business (Luis Contreras Depo., pp.12-13 and Contreras Depo Ex. 1; Conn Aff., Ex. H, S.R. 137, 149). Its Controller likewise testified that he believed the audited financial statements were correct, and that he relied on them in accounting for subsequent transactions during 1997 (Canales Depo., p. 48, S.R. 118).

The District Court also based its summary judgment on finding that there was no evidence of causation between the negligent audit and the damages claimed (Order, pp. 10-11, A. 187-8). This conclusion appears to stem from the Court's erroneous legal conclusion that "deepening insolvency" was damage to Technimar's creditors, not to Technimar (Order, pp. 9-10, A. 186-7). The conclusion ignores the fact that Luis Contreras testified that he relied on the financial statements in the conduct of Technimar's business, that he provided the information to the MPRA, and that he was the officer who signed the many promissory notes for loans from the MPRA. (L. Contreras Depo. p. 7, S.R. 136). The conclusion also ignores the testimony from the representatives of the MPRA that they would have halted the loans and taken action sooner if they had known that Technimar did not in fact have a $10 million net worth (Berryman Depo., pp.13-17, 22-3, S.R. 282, 284.

The conclusion further ignores Grant Thornton's Debt Compliance Letter to Heller and the notes in its audit that Technimar was in compliance with the restrictive covenants in the Heller Financing. Because of its redemption of Breton's Valent shares, it was in violation of the loan covenants from the outset, a violation which would have existed if the December Agreement had never occurred, because the September Agreement also obligated redemption of Breton's investment. Heller's loan officer testified that if the Debt Compliance Letter had said that the debtor was not in compliance with the loan requirements, he would have reported it to management and discussed it with the company, with further action depending "on what further information we uncovered." (Schoultz Depo. pp. 30-33, Conn. Aff. Ex. P).

What we do know is that when Heller discovered Technimar's noncompliance, it gave its notice of default and exercised its rights against its collateral security, which led to further management changes at Technimar, the engagement of Coy and Associates, William Goblirsch, and ultimately the Chapter 11 bankruptcy filing.

If Grant Thornton's audited financial statements had reflected Technimar's true situation, damage would have been avoided. Work-out discussions with Heller and major creditors could have commenced, and, failing resolution, bankruptcy protection could have been had at a time when success was possible. The Heller foreclosure could have been avoided, or stayed under 11 U.S.C. § 362. The avalanche of loans from the police and fire pension funds would not have happened. Even short of a successful reorganization, there was value in the company, and in bankruptcy, Technimar's interest in the Breton contract could have been assumed and assigned under 11 U.S.C. § 365 (f), permitting some recovery of Technimar's $9 million-plus investment. "In the world of corporate workouts, turnaround managers and the possibility for a quick change in an economic tide, it is not uncommon for a corporation to revitalize itself and work out financial problems no matter how dire they appear," In re Flagship Healthcare, Inc., 269 B. R. 721 (Bankr., S. D. Fla. 2001) (recognizing claim for deepening insolvency against financial advisor).

On summary judgment, the non-moving party is entitled that all inferences be made in its favor, and on appeal, the evidence must be viewed in the light most favorable to the non-moving party. In this case, in the context of summary judgment, the bankruptcy trustee was entitled to an inference that remedial action could have and would have been taken, not to the inference drawn by the District

Court that Technimar's subsequent damages were unrelated to the audited financial statements.

Conclusion

Grant Thornton's unqualified audit opinion and Debt Compliance Letter led to Technimar's deepening insolvency and ultimately to its demise. As set forth above, there are numerous factual disputes and the Trustee has alleged valid legal claims. The District Court ignored evidence in the record contrary to its conclusions, and impermissibly drew inferences adverse to the non-moving party. Appellant Julia A. Christians, as Trustee for the Bankruptcy Estate of Technimar Industries, Inc., respectfully requests that the summary judgment be reversed, and the case remanded for trial.

September 5, 2006 KALINA, WILLS, GISVOLD & CLARK, P.L.L.P.

By: ______________________

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The appendix to this brief is not available for online viewing as specified in the *Minnesota Rules of Public Access to the Records of the Judicial Branch*, Rule 8, Subd. 2(e)(2) (with amendments effective July 1, 2007).