NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW JERSEY

IN RE:	:	CHAPTER 11
Grand Court Lifestyles, Inc.,	:	CASE NO. 00-32578 (NLW)
Debtor.	:	
The Post Confirmation Committee of Unsecured Creditors	:	
Plaintiff,	:	
v.	:	
Deloitte & Touche, LLP,	:	ADV. NO.: 02-3424
and	:	
BDO Seidman, LLP.,	:	
Defendants,	:	

Before: HON. NOVALYN L. WINFIELD

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This matter is before the Court on a motion for partial summary judgment brought by the defendant, Deloitte & Touche LLP. As set forth at greater length below, the Court concludes that partial summary judgment should be granted.

This Court has jurisdiction to consider this matter pursuant to 28 U.S.C. §§ 1334 and 157(a) and the Standing Order of Reference issued by the United States District Court for the District of New Jersey on July 23, 1984. As permitted by 28 U.S.C. § 157(b)(3), this Court determines that this proceeding is a non-core matter inasmuch as (i) it is grounded in a prepetition business relationship and (ii) its resolution is governed by state law rather than any provision of title 11.

PROCEDURAL AND FACTUAL HISTORY

A. The Partial Summary Judgement Motion

Grand Court Lifestyles, Inc. (the "Debtor") filed its Chapter 11 petition on March 20, 2000 ("Petition Date") and was continued in possession of its property and management of its affairs as a debtor-in-possession. On or about April 6, 2000 the United States Trustee formed an Official Committee of Unsecured Creditors (the "Committee"). In the course of the Chapter 11 case the Committee sought, and received, authorization from the Court to assert any claims that the Debtor might have against Deloitte arising from Deloitte's audit of the Debtor's financial statements for the years 1994, 1995, 1996, and 1997. The Committee first filed a Complaint against Deloitte in July 2002.[1] Thereafter, an Amended Complaint was filed in September 2002, and a Second Amended Complaint ("*SAC*") was filed in September 2003.

The partial summary judgment motion presently before the Court has evolved considerably

[1]The Complaint also named BDO Seidman LLP, a successor auditor, as a defendant.

from its initial focus. At the outset, Deloitte moved for partial summary judgment on all claims of the Second Amended Complaint that sought damages based on the theory of deepening insolvency.[2] The Committee claimed that the Debtor was actually insolvent even prior to the Petition Date, and that "its liabilities exceeded the fair market value of its assets throughout the period that defendants provided accounting services to [the debtor]." (*SAC* ¶ 45.) Further, the Committee alleged that inaccurate financial statements audited by Deloitte caused the Debtor "to operate and assume substantial additional debt in the form of, *inter alia*, (i) commercial loans; (ii) securities issued in private offerings; and operating expenses when, in fact, the Company's assets were incapable of supporting this additional debt so that the [Debtor's] insolvency deepened as it continued to operate." *(SAC* ¶ 44.)

Deloitte's motion was primarily based on *Seitz v. Detweiler, Hershey Assoc., P.C. (In re CitX Corp.)*, 448 F.3d 672, 677-681 (3d Cir. 2006)(a claim of negligence cannot sustain a deepening insolvency cause of action or theory of damages). In Deloitte's view, the only claim left in the *SAC* is a breach of contract claim for return of Deloitte's audit fees.

The Committee's opposition to the Deloitte motion conceded that the *CitX* decision appeared to preclude the Committee from relying on deepening insolvency as a theory of damages for its breach of contract, negligence, and negligent misrepresentation claims. However, the Committee argued that "the Committee's *SAC always* has included the potential for recovery of more "traditional" damages under tort and contract theories and. . .nothing supports Deloitte's demand that the Court now dismiss the Committee's claims and preclude the Committee's pursuit of

[2]The SAC asserted Breach of Contract (Count I), negligence (Count II) and negligent misrepresentation (Count III).

damages under these more traditional theories of recovery." (*Plaintiff's Opp.* 4.) The Committee maintained that these damages were identified in deposition testimony by Brian Moore ("Mr. Moore"), the Committee's Rule 30(b)(6) witness, and in the Committee's Supplemental Response to Interrogatory No. 5. The Supplemental Response to Interrogatory No. 5 stated in pertinent part:

> Supplemental Response to Interrogatory No. 5
>
> Deloitte's contention that "the Committee must have some information relating to the damages information requested in order to have a basis for filing the complaint" is both unintelligible and inaccurate. In any event, the Committee provided information related to damages in its initial response and supplements that response by stating that the Committee also intends (i) to seek recovery of all amounts required to fully satisfy all unsecured or under secured claims filed in the Grand Court bankruptcy proceeding; and (ii) to seek damages related to the costs associated with Grand Court's continued operation after becoming insolvent but before filing for bankruptcy. These latter damages are likely to include, inter alia, (a) the costs and expenses associated with any syndications and securities offerings conducted by Grand Court after insolvency whether in the form of limited partnership syndications or company debt offerings, and (b) all carrying costs associated with the continued operation of real estate and the conduct of partnership operations after insolvency.
>
> The Committee has not yet determined the amount of damages attributable to item (ii), above. As regards item (i), to date, the Committee's estimate of the under and unsecured creditor claims base is approximately $128 million and, in addition to distributions made to the Estate of George Batchelor and to secured debenture holders, the Plan Administrator has made distributions totaling approximately $6.4 million to unsecured creditors from liquidated assets. The Plan Administrator is continuing the process of liquidating the multi-family properties.
>
> The Committee is continuing its analysis of Grand Court's deepening insolvency and, other than as described above and in Plaintiff's initial interrogatory responses, has not yet identified all specific categories, or amounts, of damages attributable to Grand Court's continued operation after becoming insolvent.

(*Rosenman Cert. Ex. 5* at 8-9.)

Mr. Moore's deposition testimony relied upon by the Committee stated the following:

> Q. Do you believe that Grand Court's insolvency significantly deepened during the years preceding the Chapter 11 filing?
>
> A. Yes.
>
> Q. Given that the committee, at this point, has not quantified the amount of insolvency at any given point in time, how is it that you reached that conclusion?
>
> A. Well, I think if you examine the activities of Grand Court from 1996 forward, and look at the variety of things that were going on during those years, the economics of the syndications, the guarantees associated with the syndications, the guarantees of shortfalls, the guarantees of returns, the failure of – what I referred to as the "business model", the incurrence of additional debt as a result of pledging purchase notes, the public offering, if I didn't mention that, the public offering – um – the prepayment of investor notes, the hypothecation of those investor notes that weren't prepaid, the whole volume of cash flows and cash in to Grand Court, you know, was funding nothing more than problems and increasing very, very high level of debt, that whole – the whole dynamics of that business model, from each and every year just kept getting worse and getting worse and getting worse, going from 20 syndications to 52 syndications, a senior living including guarantees and including the operating shortfalls, the impairment problems with the notes – um – and, yet, the notes utilized to raise more debt, the activity with – when you consider the activity with Mr. Batchelor, with respect to Mr. Batchelor being approached as a lender, if you look at this whole volume of cash that came in to Grand Court, its's just gone, just gone. Interest costs of the debentures, the interest cost of the notes, the cash cost of the guarantees, the cash cost of the funding shortfalls – um – just a terrible set of occurrences.

(*Certification of George W. Croner ("Croner Cert.") in Support of Plaintiff's Opp. to Defendant Deloitte & Touche LLP's Motion for Partial Summary Judgment Ex. A* (*Moore Dep.* 881:18-883:18.).) The Committee contended that "Mr. Moore's testimony provides a lengthy description

of the types of losses exacerbating the debt load at Grand Court as the company continued to operate while insolvent," and that "they also represent components of damages recoverable on the Committee's claims if the Committee can establish that Grand Court suffered losses engaging in these business activities while relying on Deloitte's unqualified audit opinion that the company's financial statements fairly presented the company's financial condition in all material respects." (*Plaintiff's Opp.* 10.)

Unable to discern from the foregoing how the Committee's description of its traditional damage theories differed in scope or nature from its deepening insolvency theory of damages, the Court adjourned Deloitte's partial summary judgment motion and required the Committee to provide a more concrete description of the damages suffered by the Debtor resulting from the financial statements allegedly negligently audited by Deloitte.

The Committee's response was twofold. First, its counsel submitted a declaration under Fed. R. Civ. P. 56(f) stating that material discovery remained incomplete. Counsel stated that various depositions, including those of the Debtor's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") had not been taken, and this precluded the Court from addressing the factual sufficiency of the Committee's proof of causation. Second, with regard to the damages suffered by the Debtor, the Committee identified two specific areas of operation where it claimed the Debtor incurred out of pocket economic losses in reliance on its financial condition as depicted in financial statements audited by Deloitte. The committee claimed that the Debtor made cash advances (described as loans and exchange, or "L&Es") to certain multi-family partnerships "in reliance on its audited financial statements which consistently valued the Multi-Family Notes associated with these multi-family properties in the range of $175M." (*Plaintiff's Supp. Opp.* 11.) Additionally, the

Committee claimed that the Debtor relied upon the Deloitte audited financial statements when it entered into management contracts ("Management Contract Obligations") to manage senior living facilities following syndication of the limited partnership interest in those facilities.

Despite the vigorous objections raised by Deloitte to the Rule 56(f) declaration, the Court determined that it was appropriate to further adjourn the motion for partial summary judgment to afford the Committee the opportunity to depose the witnesses it claimed were essential to establish damages based on the L&Es and the Contract Management Obligations. Though not fully articulated by the Court on the adjourned hearing date, the Court permitted the depositions because counsel for the Committee represented that the Debtor's expenditures for L&Es and Contract Management Obligations were now the only basis on which the Committee sought damages. Thus, it was the Court's intent to provide the Committee the opportunity to provide a factual basis for its claim of damages. Accordingly, the Court did not decide the motion. Rather, the Court permitted the Committee to take the depositions of the Debtor's CEO and CFO, and directed both parties to thereafter file final submissions regarding Deloitte's motion.

The deposition of John Luciani ("Mr. Luciani"), the Debtor's CEO, was taken in March 2007 and was completed. (*Deloitte's Supp. Stmt. of Undisputed Facts* ¶ 48.) The deposition of Catherine Merlino ("Ms. Merlino") the Debtor's CFO, was taken in May 2007. (*Id.* ¶ 50.) Although, the deposition was not completed, both the Committee and Deloitte agree that for the purpose of the issue raised in Deloitte's motion the Merlino deposition can be considered closed. (*Id.* ¶ 51.) It also appears that as a result of the discovery taken while Deloitte's motion has been pending, the Committee's damage claim based on Management Contract Obligations with the senior living communities has been eliminated. The Committee now concedes that the evidence shows that the

Management Contract Obligations were assumed by the Debtor prior to Deloitte's retention as the Debtor's auditor. (*Plaintiff's Second Supp. Opp.* 3 n.2.)

B. The Debtor's Business

To assess the Committee's remaining damage theory, a bit of operational history is helpful. Together with Bernard M. Rodin ("Mr. Rodin"), Mr. Luciani formed the predecessor to the Debtor. (*Deloitte's Supp. Stmt. of Undisputed Facts* ¶ 52.) The Debtor was incorporated in 1986 to consolidate the various corporate and partnership assets of its predecessor entities and certain of their affiliates (the "Predecessor Companies"). (*SAC* ¶ 18.) Mr. Luciani served as the CEO and Chairman of the Board at all times after the Debtor was formed. (*Deloitte's Supp. Stmt. of Undisputed Facts* ¶ 53.) With respect to financial matters, Mr. Luciani relied on Mr. Rodin "appreciably." (*Id.* ¶ 55.) In the period that Deloitte served as the Debtor's independent auditor Mr. Rodin had overall responsibility for the financial reporting function at Grand Court. (*Id.* ¶ 58.) In the same period, Mr. Rodin also "always oversaw the marketing or selling of limited partnership interests" in Grand Court's senior living syndications. (*Id.* ¶ 59.) Mr. Rodin died on October 25, 1999. (*Id.* ¶ 60.) Upon Mr. Rodin's death Ms. Merlino was appointed CFO and Principal Accounting Officer. (*Id.* ¶ 66.) When Deloitte was the Debtor's auditor Ms. Merlino had principal responsibility, second only to Mr. Rodin, for preparing the Debtor's financial statements. (*Id.* ¶ 67.)

Prior to 1986, certain Predecessor Companies acquired or developed, and in most cases, managed multi-family properties located in the Sun Belt and the Midwest (*SAC* ¶ 20.) The acquisition and financing of these multi-family properties were funded through a combination of

mortgage debt and private investment raised through the syndication of the multi-family properties in private placement limited partnership offerings. *Id.* These Predecessor Companies subsequently relinquished their management of the multi-family properties and their interests in the partnerships that owned the multi-family properties. (*SAC* ¶ 25.) As a result, by the Petition Date, the Debtor's interests in the multi-family properties were as a holder of purchase notes from the limited partnerships that invested in the multi-family partnerships, and receivables due from the multi-family limited partnerships. By the time that the Debtor filed its Chapter 11 case, the Debtor was the holder of 159 notes and various L&Es from the partnerships that owned directly or indirectly 117 multi-family properties. *(Debtor's Second Amended Disclosure Stmt.*, Dkt # 1396, at 8-9.)

Beginning in 1986, the Predecessor Companies focused their business on the acquisition, development and syndication of senior living communities.[3] (*SAC* ¶ 21.) The senior living communities, like the multi-family properties, were largely acquired and developed by use of mortgage debt and capital raised through syndication of limited partnerships. (*Id.*) When the Debtor's Chapter 11 case began, it managed approximately 57 senior living communities. (*Debtor's Second Amended Disclosure Statement* 9.)

C. Description of the Notes and Receivables in the Financial Statements

On the Debtor's Financial Statements, the balance sheet line item "Notes and Receivable Net" includes both multi-family and senior living receivables. There is no information specific to

[3]The Debtor was a fully integrated provider of senior living accommodations and services. The goal of the senior living communities was to provide "personalized assistance, supportive services and select health services in a professionally managed group living environment." (*Debtor's Second Amended Disclosure Statement* 9.)

a particular property. (*Deloitte's Supp. Stmt. of Undisputed Facts* ¶ 75.) In each of the financial statements audited by Deloitte, footnote four provides additional information about this line item, but does not provide any information regarding the face value or the carrying value[4] of any specific multi-family purchase note. (*Id*. ¶ 76.) Footnote four simply identifies, "Notes and Receivables-Net" as notes receivable, other partnership receivables, mortgages, and accrued interest receivable. (*Committee's Supp. Stmt. Of Undisputed Facts* ¶ 122.)

In footnote four, a single figure of approximately $175 million reflects the collective face amount for the entire portfolio of notes receivable (*Deloitte's Supp. Stmt. of Undisputed Facts* ¶¶ 76- 77). According to Ms. Merlino, the $175 million figure does not reflect any judgment as to the collectability or value of the notes. (*Id.* ¶ 77.) Ms. Merlino further agreed that a reader looking at footnote four would not be able to determine anything about the value or collectability of any particular note. (*Id.* ¶ 79.)

D. <u>The L&E Advances</u>

The "other partnership receivables" described in footnote four "substantially represent reimbursable expenses and advances made to the multi-family partnerships." (*Committee's Supp. Stmt. of Undisputed Facts* ¶ 125.) These receivables were known by the Debtor as L&Es and refer to "dollars advanced by [the Debtor] to various partnerships that owned properties." (*Id.*) The Debtor had no legal obligation to make L&E advances. (*Id.* at 126.) Further, the Debtor neither

[4]Carrying value is generally understood as book value. Ms. Merlino testified that the carrying value of the multi-family purchase notes was the face value of the notes less any associated deferred income. *(Second Supp. Rosenman Cert., Ex. B. (Merlino Dep. at 146:22-148:2)).*

owned nor managed any of the properties for which L&E's were advanced. (*Id.*)

Most requests for L&E advances originated with Edward Glatz ("Mr. Glatz"). (*Committee's Supp. Stmt. of Undisputed Facts* ¶ 134.) Mr. Glatz, a Vice President of the Debtor, reviewed the multi-family properties with Westmark Management, a third-party property manager, and then made recommendations to Mr. Luciani. (*Deloitte's Supp. Stmt. of Undisputed Facts* ¶ 85.) Mr. Luciani reviewed Mr. Glatz's recommendations with Paul Jawin ("Mr. Jawin") who was also an officer of the Debtor. (*Id.* ¶ 86.) However, Mr. Luciani was the ultimate decision-maker. In his deposition Mr. Luciani described his decision-making regarding Mr. Glatz's recommendations as follows:

> Q: Let's talk about that side of the house, the multi-family side. Who decided whether or not a given L&E would be funded on the multi-family side?
> A. Several people. Let's start with myself. The multi-families were supervised by Mr. Glatz and he traveled most all of the jobs. He would send in his reports as to in his opinions what the jobs may need for either repair, maintenance, et cetera. That was then worked on by Paul and myself, and I would decide over what period of time we would fund X dollars to do this work.
>
> Q. Were you the ultimate decision maker?
> A. On those L&Es, yes.
>
> Q. The recommendations would come in from Mr. Glatz?
> A. Yes.
>
> . . . .
>
> Q. And you would review them then with Mr. Jawin but ultimately you would be the decision maker?
> A. Yes.
>
> Q. Did you approve – again, the process was you would get a recommendation from Mr. Glatz?
> A. On those jobs that required work, maintenance, exactly, deferred maintenance, yes.

Q. Did you approve all recommendations you received from Mr. Glatz?
A. Substantially all, not all.

Q. What – give us an example of the types of requests for funding you would agree upon?
A New roofs, he would give me a couple of estimates. We would focus then on a contract and/or a price. And we would decide over what time frame we would do that. I wouldn't necessarily do them all at one time. Some of those various fundings as we are referring to them took place over months. We would keep an ongoing schedule that Paul kept as to the progress and what dollar amounts we funded and what expectations we met as we projected to meet or as was projected to meet.

(*Second Supp. Rosenmann Cert. Ex. A.* (*Luciani Dep.* 116:1-20; 117:12-118:5.).) Mr. Luciani further described his decision-making regarding the multi-family properties as follows:

Q. In deciding whether or not you agree to go forward with the advance, would you be analyzing the property and seeing whether or not the investment made any sense?
A. Yes.

Q. Would you be considering the economic performance of the property to whom the advance was being proposed?
A. Either then or to be achieved, yes.

Q. What other factors, if any, would you take into account in deciding whether or not to go along with Mr. Glatz' recommendations?
A. Those are essentially the major reasons.

(*Id.* 125:4-16.) Mr. Jawin's deposition testimony essentially confirms that the decision-making process identified by Mr. Luciani. Mr. Jawin stated that there was "sort of a cost/benefit analysis, looking down the road and seeing which properties had better chances of success and which didn't." (*Second Supp. Rosenmann Cert. Ex. C* (*Jawin Dep.* 180:6-9.).)

Mr. Luciani further testified that in authorizing the L&Es he believed that he was serving the Debtor's interest. (*Second Supp. Rosenmann Cert. Ex. A* (*Luciani Dep.* 118:12-14.).) Asked to explain his belief, Mr. Luciani stated: "[t]hat which was assigned to Grand Court from the multi-family portfolio was all of the purchase notes on the various jobs as many of the jobs as there was at that time. So that Grand Court had, if you will, an equity or a receivable in the multi-family portfolio." (*Id.* 118:16-21.)

It also appears that in addition to physical improvements for the multi-family properties, L&Es were advanced to certain multi-family partnerships in order to avoid foreclosure. (*Id.* 118:22-25.) The advances were made mostly at the direction of Mr. Rodin, but with Mr. Luciani's acquiescence. (*Id.* 119:9-17, 122:20-24, 123:24-124:1.) According to Mr. Luciani, the Debtor sought to avoid foreclosure because foreclosure would subject the limited partners to adverse tax consequences in the form of depreciation recapture. (*Id.* 119:18-120:8.) Mr. Luciani stated that Mr. Rodin contended that the tax recapture should be avoided because it hurt the same people to whom the Debtor was marketing syndications. (*Id.* 121:2-5.) "A good number of the limited partners [in the multi-family partnerships] were also limited partners in the Grand Court syndications [of senior living partnerships], same people." (*Id.* 120:22-24.)

Significantly, Mr. Luciani did not testify that he either used or relied upon the Debtor's financial statements when he made decisions to make L&Es to or on behalf of multi-family partnerships. Mr. Luciani did agree that the fact that the Debtor's financial statements were audited gave him confidence that the value of notes and receivable was accurately stated on the Debtor's balance sheet. (*Id.* 503:14-20.) However, more specifically, Mr. Luciani testified that he did not refer to the financial statements prior to authorizing a L&E for a multi-family property:

Q. Okay. Now, Mr. Croner asked you about the L&E advances. You recall that generally?
A. Yes.

Q. And he asked you at one point if the advances were made to protect the purchase notes, do you recall that?
A. Yes.

Q. Okay. Now, using the same set of financials as an example, the one in the '98, 10-K, if you go back to page 50, do you have that now?
A. Yes.

Q. Looking again at the $173 million figure shown as of 1/31/98 for the multi-family purchase notes, let's for a minute forget the deferred income and reserves and other issues we talked about. Let's just focus on this one number. Let's assume that was the only number relevant to the carrying value. Now, that number was for the portfolio as a whole, correct?
A. Yes.

Q. Can you from that one number, that $170 million figure, can you deduce what the purchase note was at any given property?
A. No.

Q. At the time as of January 31, 1998, approximately how many multi-family properties did Grand Court have in connection through its purchase notes?
A. Approximately 100.

Q. And so there are 100 different properties all bundled up into that one number, the $173 million figure, correct?
A. In properties, yes. In purchase notes even more in volume.

Q. Even more than 100?
A. Well, more in terms of individual pieces of paper. Some of the purchase notes were done in the investing partnership in like four purchase notes rather than one.

Q. Understood. Now, to the extent you wanted to determine, Mr. Luciani, whether or not there was value in any single property over and above the mortgage, the first mortgage amount, would this $173,598,000 figure tell you anything

about that question?
A. No.

Q. Did that number, that $173,598,000 figure give you – first of all, before making any L&E advance did you pull out any financial statement and look up footnote 4 to see what the multi-family note balance was?
A. No.

Q. Had you done it would that have given you enough information on whether or not to make an advance or not?

MR. BERMAN: Objection to form and foundation.

THE WITNESS: No.

(*Id.* 548:23-551:5.)

In fact, Mr. Luciani explained that he didn't really understand the financial statements, and that when he made his decisions regarding expenditures for the Debtor he relied upon "that which may have been reported to me or my best judgment." (*Id.* 489:11-12.) In his deposition he testified as follows:

Q. When you made the decisions to spend significant amounts of for Grand Court, what sort of things did you rely upon in deciding to spend the money?
A. That which may have been reported to me or my best judgment.

Q. How did you know at any particular point in time how much money Grand Court had to spend?
A. Only by what was in the bank.

Q. Did you get the bank statements regularly as the chief executive officer of the company.
A. I knew the bank balances regularly.

Q. As the chief executive officer of the company did you have an idea of what your balance sheet looked like?
A. I think I have explained before, I have – I do not have the knowledge or the ability with respect to understanding a

statement or balance sheet as such.

Q. But did you have some idea – did you know, sir, as the chief executive officer of the company whether your company was solvent?
A. Solid?

Q. Solvent.
MR. MEDOW: Object to the form of the question.
THE WITNESS: Yes.

BY MR. CRONER:
Q. And how did you know that?
A. I had no reason to disbelieve it was not solvent.

Q. Do you ever remember seeing – did you ever remember seeing a balance sheet for Grand Court?
A. A balance sheet as opposed to a financial statement.

Q. Well, for example, we showed you – Mr. Berman had showed you one that was earlier marked as Plaintiff's Exhibit 6, the one that you were just looking at. If you will turn to the page that's F3, the Bates number DT5, do you see that consolidated balance sheet?
A. Yes.

Q. Did you as chief executive officer of the company, did you have some familiarity with what the balance sheet for Grand Court looked like?
MR. MEDOW: Objection, form.
THE WITNESS: If I had need in the areas that I was doing bank financing, these were the numbers or balance sheets that I would furnish banks. My total familiarity as such is negligible because I don't fully understand them. I know the cash. Cash to me is king.

(*Id.* 489:7-491:10.)

Ms. Merlino's deposition testimony does not shed any light on the decision-making process for advancing L&Es. Ms. Merlino stated that she did not make decisions regarding whether L&Es should be advanced. (*Second Supp. Rosenmann Cert. Ex. B* (*Merlino Dep.* 97:9-12.).) Nor was Ms.

Merlino consulted by Mr. Luciani with respect to making L&Es. (*Id. 97:15-19.)* The Committee's counsel did elicit some speculation from Ms. Merlino regarding what she thought Mr. Rodin might have done regarding L&Es to multi-family partnerships if the Deloitte audit opinion had been a qualified opinion:

> Q. All right. Ms. Merlino, I'm trying to get right the question I repeatedly stumbled over at the end there. And my question is, based on your experience in working with Mr. Rodin at Grand Court, would he have agreed to advance L&Es to multifamily partnerships if the Deloitte audit opinion had been a qualified opinion?
>
> MR. MEDOW: Objection. No foundation. Calls for speculation.
>
> A. No, I don't think he would have.

(*Id.* 888:19 to 889:5.) However, Ms. Merlino's conjecture lacks evidentiary value as she is opining not only on matters outside of her knowledge, but also on the thought process of a third party, Mr. Rodin.

CONCLUSIONS OF LAW

A. Summary Judgment

Rule 56 of the Federal Rules of Civil Procedure, made applicable to this adversary by Federal Rule of Bankruptcy Procedure 7056, provides that "summary judgment shall be rendered forthwith if the pleadings, depositions, answers to interrogatories and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." *Fed. R. Civ. P.* 56(c). The party seeking summary judgment bears the initial burden of identifying evidence that demonstrates the absence of a genuine issue of material fact. *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986). To survive

a summary judgment motion the non-moving party must set forth specific facts showing that a genuine issue exists for trial. *Fed. R. Civ. P.* 56(e)*; Celotex*, 477 U.S. at 325. An issue is "genuine" if a reasonable jury could possibly hold in the nonmovant's favor on the issue. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 247-48 (1986). A fact is "material" if it influences the outcome under the governing law. *Id.* at 248.

It is well understood that when ruling on a summary judgment motion a court must draw all inferences from the underlying facts in a light most favorable to the nonmovant. *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 587-88 (1986). Nonetheless, "[w]hen the moving party has carried its burden under Rule 56(c), its opponent must do more than simply show that there is some metaphysical doubt as to the material facts." *Id.* at 586. Further, the Court in *Anderson* held that the standard for granting summary judgment is the same as that for granting a direct verdict under *Fed. R. Civ. P.* 50. 477 U.S. at 250-51. The Court explained that

> the judge must ask himself not whether he thinks the evidence unmistakably favors one side or the other but whether a fair-minded jury could return a verdict for the plaintiff on the evidence presented. *The mere existence of a scintilla of evidence in support of the plaintiff's position will be insufficient;* there must be evidence on which the jury could reasonably find for the plaintiff.

Anderson, 477 U.S. at 252 (emphasis added). *See also Big Apple BMW, Inc. v. BMW of N. Am., Inc.*, 974 F.2d 1358, 1363 (3d Cir. 1992).

The substantive law provides the basis for identifying which facts are material, and "[o]nly disputes over facts that might affect the outcome of the suit under the governing law will properly preclude the entry of summary judgment." *Anderson*, 477 U.S. at 248. New Jersey courts have recognized that "[a]n incorrect statement, negligently made and justifiably relied upon, may be the basis for recovery of damages for economic loss or injury sustained as a consequence of that

reliance." *H. Rosenblaum, Inc. v. Adler*, 93 N.J. 324, 334 (1983). Reliance on the misstatements must be shown in order to establish that the misstatements are a proximate cause of damages. *Id. at 350; See also Kaufman v. I-Stat Corp.*, 165 N.J. 94, 109 (2000)("The actual receipt and consideration of any misstatement remains central to the case of any plaintiff seeking to prove that he or she was deceived by the misstatement or omission."). Under New Jersey tort law proximate cause is established "'where. . .conduct is a substantial contributing factor in causing [a] loss.'" *McCabe v. Ernst & Young, LLP*, 494 F.3d 418, 438 (3d Cir. 2007)(quoting *2175 Lemoine Ave. Corp. v. Finco, Inc.*, 272 N.J. Super 478, 487 (N.J. Super. Ct. App. Div. 1994)).

B. Reliance on the Financial Statements

Now that the Committee concedes (i) that deepening insolvency is no longer a viable theory of damages, and (ii) that the Management Contract Obligations were assumed by the Debtor prior to Deloitte's engagement, its claim for damages rests solely on the L&Es advanced by the Debtor to various multi-family partnerships. The Committee claims that Deloitte's unqualified audit opinions caused Grand Court to rely on the value of the notes and receivables reflected in the financial statements when it advanced L&Es to the multi-family partnerships. Focusing on the evidence adduced to date in this protracted adversary proceeding (including the depositions of Mr. Luciani and Ms. Merlino requested by the Committee), Deloitte contends that there is no evidence that the Debtor advanced even one L&E based on the valuation of notes and receivables in the financial statements. After considering the record presented in connection with this summary judgment motion the Court agrees and grants partial summary judgment in favor of Deloitte.

A review of this record amply reveals that no fair-minded jury could reasonably find for the

Committee. The deposition testimony of Mr. Luciani recited earlier in this opinion makes it plain that he was the ultimate decision-maker regarding L&E advances. The depositions of Ms. Merlino and Mr. Jawin corroborate this fact. Mr. Luciani stated that he largely made his decisions regarding physical improvements to the property based on the recommendations of Mr. Glatz, although he discussed them with Mr. Jawin. Mr. Luciani also testified that when L&Es were advanced to avoid foreclosure, they were made mostly at Mr. Rodin's direction, but with Mr. Luciani's acquiescence. Mr. Luciani stated that he understood that Mr. Rodin desired to avoid foreclosure in order to protect the limited partners from tax consequences.

The Committee provided no deposition testimony or documentary evidence that even suggested that the financial statements were considered by Mr. Luciani or Mr. Rodin when the L&E decisions were made. Indeed, Mr. Luciani flatly testified that he didn't understand the financial statements. Instead, he stated that he analyzed the specific properties to decide whether an advance was appropriate.

Nor did the Committee offer any testimony from Ms. Merlino that established reliance on the financial statements to make L&E advances. Ms. Merlino stated that she did not participate in any of the decision-making regarding L&E's and that she did not know the reasons for making the advances. As a consequence, her speculation that Mr. Rodin would not have agreed to advance L&Es if the Deloitte audit opinion had been qualified is wholly speculative and unsupported. Mr. Jawin's testimony likewise fails to even suggest a degree of reliance. He testified that the decisions were ultimately made by Mr. Luciani, and that he did not know how they were made. The Committee did not even adduce testimony from either Mr. Jawin or Ms. Merlino that their analysis of the financial statements informed even one discussion with Mr. Luciani regarding the L&E

advances.

At best, the Committee points the Court to Mr. Luciani's testimony that the L&Es were advanced to preserve the value of the notes held by the Debtor, and that he would not approve any L&E for a multi-family property where he thought that an associated note did not have value. However, these general statements are not inconsistent with Mr. Luciani's other testimony, and notably, do not evidence any reliance on the financial statements audited by Deloitte. As evidenced by the financial statements themselves, there is no information in the balance sheet line item "Notes and Receivable Net" that identifies specific properties or notes. Also, the Committee contends that Mr. Luciani's discussions with Mr. Rodin, Ms. Merlino and Mr. Jawin, who were knowledgeable about the financial statements, show that the information on the financial statements was a substantial factor in the decision-making regarding L&Es. But this assertion is equally unsupported. The Committee offers no documentation or testimony that purports to explain how the familiarity with this information by Ms. Merlino and Messrs. Rodin and Jawin could aid Mr. Luciani in the property-by-property analysis that he performed. In the absence of some linkage, the Committee's contention does not even rise to the level of a scintilla of evidence.

C. Reliance as a Substantial Factor

The Committee argues that the Deloitte motion for summary judgment as it pertains to the L&E advances must be denied because under §546 of the *Restatement (Second) of Torts* reliance need only constitute a substantial factor in the conduct that results in loss. In particular, the Committee relies on *Comment b* which provides that reliance upon a fraudulent representation need not be a sole or decisive factor in influencing a party's conduct - rather, it is enough that the

misrepresentation is a substantial factor.

The Court finds the Committee's position erroneous and unhelpful. As Deloitte observes, the Committee ignores the reality that § 546 addresses only fraud claims.[5] Additionally, *Comment b* to § 546 directs the reader to contrast its analysis with that found in § 432 of the *Restatement (Second) of Torts* which provides:

> § 432. Negligent Conduct as Necessary Antecedent of Harm
>
> > (1) Except as stated in Subsection (2), the actor's negligent conduct is not a substantial factor in bringing about harm to another if the harm would have been sustained even if the actor had not been negligent.
> >
> > (2) If two forces are actively operating, one because of the actor's negligence, the other not because of any misconduct on his part, and each of itself is sufficient to bring about harm to another, the actor's negligence may be found to be a substantial factor in bringing it about.

Nor do the cases cited by the Committee support its position. *In re Santos*, 304 B.R. 639 (Bankr. D.N.J. 2004), addressed only claims sounding in fraud and therefore its application of § 546 was appropriate. *Kaufman v. I-Stat Corp.*, 165 N.J. 94 (2000) and *Bondi v. Citigroup, Inc.*, No. BER-L-10902-04, 2005 WL 975856 (N.J. Super. Ct. Law Div. Feb. 28, 2005) simply stated that reliance is an element of a cause of action for fraud as well as negligent misrepresentation. Equally unpersuasive is the Committee's reliance on *Total Petroleum, Inc. v. Davis*, 788 F.2d 476, 482 (8th Cir. 1986); *Seaboard Sur. Co. v. Permacrete Constr. Corp.*, 221 F.2d 366, 371 (3d Cir. 1955) and

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[5] § 546 states:

> The maker of a fraudulent misrepresentation is subject to liability for pecuniary loss suffered by one who justifiably relies upon the truth of the matter misrepresented, if his reliance is a substantial factor in determining the course of conduct that results in his loss.

United States v. Am. Precision Prods. Corp., 115 F. Supp. 823, 830 (D.N.J. 1953). All of the foregoing cases make reference to § 546 as part of a discussion that addresses either reliance on, or liability for, a fraudulent misrepresentation. Accordingly, the cases do not support the Committee's contention that § 546 applies to negligent misrepresentation.

However, examination of Mr. Luciani's reliance on the financial statements as a substantial factor causing injury to the Debtor is nonetheless properly a subject of consideration. The *Restatement (Second) of Torts* at § 434(2) provides in pertinent part that:

> It is the function of the jury to determine, in any case in which it may reasonably differ on the issue,
>
> (a) whether the defendant's conduct has been a substantial factor in causing the harm to plaintiff. . . .

But this does not mean that causation is only a subject for the fact-finder. Section § 434(1) also provides in pertinent part that:

> It is the function of the court to determine
>
> a) whether the evidence as to the facts make an issue upon which the jury may reasonably differ as to whether the conduct of the defendant has been a substantial factor in causing harm to the plaintiff. . . .

The problem for the Committee in the instant adversary proceeding is that it must still show that a real issue exists as to Mr. Luciani's reliance on the financial statements.[6] In the face of Deloitte's

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[6]*Comment c* further explains the function of the court and jury as follows:

> c. The question of what actually occurred in any particular case is for the jury, unless this is agreed upon, admitted by the pleadings, or found by special verdict, or unless the testimony is so undisputed and uncontradictory that there is only one inference which reasonable men could draw from it. If this is the case, the court must determine whether the actor's conduct is a substantial factor in bringing about the plaintiff's harm, unless this question is itself open to reasonable difference of

motion for summary judgment, the Committee had the burden of putting forth evidence that demonstrated the existence of a genuine issue of material fact. That is, the Committee was required to set forth facts that demonstrated reliance on the financial statements by Mr. Luciani or Mr. Rodin when L&Es were advanced. Because the Committee provided no testimony or document that established any discussion regarding the financial statements, its contents, or the preparation for the financial statements between or among Ms. Merlino, Messrs. Rodin, Jawin and Luciani, it has failed to show that reliance on the financial statements was a substantial factor causing injury to the Debtor. Thus, there is not even a scintilla of evidence weighing against summary judgment.

CONCLUSION

The Committee concedes that *Seitz v. Detweiler, Hershey Assoc., P.C. (In re CitX Corp.),* 448 F.3d 673 (3d Cir. 2006), effectively eliminated deepening insolvency as a theory of damages. Accordingly, partial summary judgment is granted in favor of Deloitte on this issue. Further, after allowing the Committee the additional discovery it requested, and after considering the deposition testimony produced thereby, it is evident that the Committee cannot demonstrate the reliance necessary to sustain Count II (negligence) and Count III (negligent misrepresentation). Accordingly, summary judgment is granted in favor of Deloitte on these issues as well.

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opinion, in which case it is for the jury.