



ENTERED

TAWANA C. MARSHALL, CLERK
THE DATE OF ENTRY IS
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The following constitutes the order of the Court.

Signed June 1, 2004.

United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

IN RE:	§	
	§	
PRECEPT BUSINESS SERVICES,	§	CASE NO. 01-31351-SAF-7
INC., et al.,	§	(Jointly Administered)
DEBTOR(S).	§	
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STEVEN S. TUROFF, AS THE	§	
CHAPTER 7 TRUSTEE FOR	§	
PRECEPT BUSINESS SERVICES,	§	
INC., et al.,	§	
PLAINTIFF,	§	
	§	
VS.	§	ADVERSARY NO. 02-3583
	§	
ERNST & YOUNG, LLP,	§	
DEFENDANT.	§	

O R D E R

Ernst & Young, LLP (E&Y), moves the court for a summary judgment on five causes of actions asserted by Steven S. Turoff, as the Chapter 7 trustee for Precept Business Services, Inc. Turoff opposes the motion. The court conducted a hearing on the motion on May 5, 2004.

Summary judgment is proper if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, and other matters presented to the court show that there is no genuine issue of material fact and that the moving party is entitled to a judgment as a matter of law.

Celotex Corp. v. Catrett, 477 U.S. 317, 322-23 (1986); Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 250 (1986); Washington v. Armstrong World Indus., Inc., 839 F.2d 1121, 1122 (5th Cir. 1988). On a summary judgment motion, the inference to be drawn from the underlying facts must be viewed in the light most favorable to the party opposing the motion. Anderson, 477 U.S. at 255. A factual dispute bars summary judgment only when the disputed fact is determinative under governing law. Id. at 250.

The movant bears the initial burden of articulating the basis for its motion and identifying evidence which shows that there is no genuine issue of material fact. Celotex, 477 U.S. at 322. The respondent may not rest on the mere allegations or denials in its pleadings but must set forth specific facts showing that there is a genuine issue for trial. Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574, 586-87 (1986).

E&Y objects to and moves to strike testimony from the declarations of William Winters and Richard Souza, submitted by Turoff in support of his response to E&Y's motion for summary

judgment. Doc. Nos. 397 and 409. Turoff filed a motion to strike E&Y's objections and motion to strike the declarations. Doc. No. 398. In an order entered May 7, 2004, the court denied Turoff's motion but granted Turoff leave to file a sur-reply brief and leave to file a response to E&Y's objections and motion to strike the declarations. Turoff filed his sur-reply brief and his response on May 13, 2004. Doc. Nos. 403 and 405. Without leave of court, E&Y filed a reply to Turoff's response on May 20, 2004, Doc. No. 412. On May 25, 2004, Turoff filed a motion for leave to file a sur-reply to E&Y's May 20, 2004 reply, Doc. No. 414. The court will strike E&Y's May 20, 2004, reply from the record and will deny Turoff's May 25, 2004, motion for leave to file a sur-reply.

Based on the court's review of the Winters and Souza declarations and the declarants' depositions, the court cannot conclude that the declarations are inconsistent with the depositions. Instead, it appears that the declarants should have supplemented their deposition testimony. The declarations suggest an evidentiary weight and credibility decision for the fact finder. The court overrules E&Y's objections and denies its motion to strike. Nevertheless, the court did not consider the declarations in its analysis of whether genuine issues of material fact exist.

As the court explained to the parties at the hearing on the

summary judgment motion, if the court concluded that summary judgment is inappropriate, it would merely enter an order denying the motion. The court explained that material fact disputes and competing factual inferences need not be discussed in an order denying the motion, as those factual disputes would necessarily be addressed at trial.

The court addresses briefly some of the parties' arguments.

Turoff asserts three claims of two Precept creditors, Bank One and Wells Fargo, who assigned to Turoff any claims they might have against Precept's directors and officers and professionals in exchange for a release of Turoff's claims against them and acceptance of their claims against the estate in full. The three claims are: aiding and abetting "bank fraud" (Count 4); aiding and abetting breaches of fiduciary duty (Count 10); and negligent misrepresentation (Count 11). Turoff asserts one of these claims, aiding and abetting breaches of fiduciary duty (Count 10), on behalf of Precept as well.

Turoff also asserts on behalf of Precept two other claims that are included in E&Y's motion: constructive fraud (Count 2) and accounting malpractice (Count 9).

E&Y argues that there is no evidence that the banks relied on representations by E&Y in making certain decisions. While E&Y has presented summary judgment evidence that the banks did not rely, Turoff has brought forward summary judgment evidence upon

which a fact finder could infer that there was reliance. During the hearing on the motion for summary judgment, E&Y stated that Turoff's evidence contains nothing but inferences. However, summary judgment is not proper if reasonable inferences can be drawn. There is summary judgment evidence that the banks knew E&Y audited Precept's financial statements, and there is also summary judgment evidence that the banks considered the financial statements audited by E&Y before extending credit to Precept. Turoff presented evidence of the banks' general practice of using financial information when making certain decisions. This evidence is such that a fact finder could infer that the banks did rely on representations of E&Y. E&Y claims that it was not aware of Precept's interest in obtaining credit from the banks. However, a fact finder can reasonably infer from Turoff's summary judgment evidence that E&Y was aware of Precept's interest in obtaining credit because of E&Y's involvement with Precept in a non-auditor capacity. Construing the evidence in favor of Turoff, the party opposing the motion, the court finds that these inferences create a genuine issue of material fact that defeats summary judgment.

Turoff may face a difficult task in meeting his burden of proof at trial in light of the language in the offering memorandum and the later credit agreement. However, on summary judgment, drawing reasonable inferences, the court cannot

conclude that there is no genuine issue of material fact concerning the banks' reliance.

E&Y argues that E&Y is entitled to summary judgment on the constructive fraud claim because no fiduciary or confidential relationship exists as a matter of law. E&Y premises its legal issue on a fact issue, arguing that E&Y is an "independent" auditor. Turoff has presented summary judgment evidence of E&Y's involvement with Precept other than as an auditor. From this evidence, there is a genuine issue of material fact concerning E&Y's status as an independent auditor. If the jury finds that E&Y was not an independent auditor or forfeited any independence because of other services and involvement with Precept, the legal analysis of the fiduciary or confidential relationship changes. The legal question cannot be determined until the facts are found at trial.

The court applies a similar analysis to the issue of whether the doctrine of *in pari delicto* bars Turoff's claims. As the court held in its previous ruling on motions to dismiss in this case, the applicability of the doctrine of *in pari delicto* in this case cannot be determined until the facts have been found. Applying the Rule 12(b)(6) standards, the court previously held that it could not conclude that Turoff could not prove a set of facts for adverse actions which would make the *in pari delicto* doctrine inapplicable. Similarly, using summary judgment

standards, there are genuine issues of material fact of whether there were adverse actions which would make the *in pari delicto* doctrine inapplicable. As the court discussed in the Rule 12(b)(6) motions in this case, developing case law questions whether the doctrine of *in pari delicto* should be applied to a Chapter 7 trustee. That case law may reach the Fifth Circuit. Without repeating that analysis in this decision, the court merely observes that the public policy consideration concerning the doctrine's applicability to a Chapter 7 trustee need not be considered if the jury finds there were adverse actions that would make the doctrine not applicable on its own terms. Should the jury find that there were not adverse actions, the question would then be ripe for adjudication. At that time, the district court, if desired, may refer the bankruptcy policy question to the bankruptcy court for a report and recommendation.

E&Y argues that there is no evidence of damages to Precept and no evidence of causation. There are genuine issues of material fact regarding the fraud and negligent misrepresentation claims. If Turoff establishes the elements of those claims, he must necessarily establish causation and damages. If E&Y contends that some cause other than that contained in these claims damaged the banks or Precept, that is a matter for resolution at trial.

A Chapter 7 trustee rather instinctively couches his

statement of damages in terms of the impact on creditors. But that does not negate the summary judgment evidence suggesting damages to the banks or to Precept, which the trustee may now collect. If the trustee is successful, he will distribute the recovery to Precept's unpaid creditors. Turoff apparently contends that the trier of fact may infer damages for a particular cause of action from the evidence to be presented by Turoff's expert concerning insolvency, unpaid debts, etc. Because of this litigation strategy, Turoff has not specifically itemized damages for the causes of action. Turoff may find himself, at trial, in the same predicament as the debtor in In re All Trac Transp., Inc., 306 B.R. 859, 899-907 (Bankr. N.D. Tex. 2004), where the debtor declined to itemize damages based on causes of action, instead contending that the defendant was liable for the entire demise of its business; but the debtor then failed to meet its burden of proof for that approach to damages. Nevertheless, that does not mean that Turoff has not presented sufficient evidence to survive a summary judgment, and, thereby, get to trial.

Consequently, summary judgment is not appropriate. There are genuine issues of material facts concerning several issues precluding resolution of this dispute on summary judgment. Without first considering the evidence at trial on the relationship between the parties and the extent of the banks'

reliance, if any, the court declines to resolve the parties' disagreement on the law. The legal questions presented in this litigation are best addressed after the fact finder has made its findings. The court hastens to observe, however, that this decision would not preclude the district court from declining to submit an issue to the jury after hearing the plaintiff's evidence.

In a footnote to its memorandum in support of summary judgment, E&Y renews its motion for a judgment on the pleadings, Doc. No. 307, requesting the dismissal of count 15 (turnover) and counts 21 and 22 (fraudulent transfers). As E&Y references deposition testimony of Turoff, E&Y alternatively requests that the court consider the motion as part of its request for summary judgment. In its ruling on E&Y's Rule 12(b)(6) motion, the court has previously concluded that to the extent the fraudulent transfer counts challenge the quality of services E&Y provided, the counts must be dismissed. Malpractice claims asserted against E&Y cannot be transformed into fraudulent conveyance claims. To the extent that the fraudulent transfer counts relate to overbilling or overpayment, Turoff does not now assert a claim for overbilling. In the turnover count, Turoff apparently seeks to recover the audit work papers. Turoff testified at deposition that he did not believe that the papers would have marketable value. The court takes judicial notice of the administration of

the underlying bankruptcy case. With negligible market value, Turoff has no reason to obtain these papers. Turoff's remaining functions are to complete this and a related adversary proceeding, make final distributions, and close the estates. This is not the time for Turoff to be dealing in property of "inconsequential value" to the bankruptcy estate. 11 U.S.C. § 554(a). The court will dismiss counts 15, 21 and 22.

Since the hearing on the motion for summary judgment, E&Y has filed a motion to strike Turoff's experts, document no. 406, as amended by document no. 411, and Turoff has filed a motion to strike E&Y's expert, document no. 408. These motions are set for hearing on **June 7, 2004 at 1:30.**

Based on the foregoing,

IT IS ORDERED that Ernst & Young, LLP's motion for summary judgment is **GRANTED IN PART and DENIED IN PART**. Counts 15, 21 and 22 are **DISMISSED**. In all other respects, the motion for summary judgment is **DENIED**.

IT IS FURTHER ORDERED that Ernst & Young, LLP's reply, filed May 20, 2004, is stricken from the court's record.

IT IS FURTHER ORDERED that Steven S. Turoff's motion for leave to file a sur-reply, filed May 25, 2004, is **DENIED**.

IT IS FURTHER ORDERED that Ernst & Young, LLP's objections to and motion to strike the declarations of William Winters and Richard Souza are **DENIED**.

End of Order