
IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

GREGORY S. FEHRIBACH,)	Appeal from the United States
CHAPTER 7 TRUSTEE)	District Court for the Southern
OF TAURUS FOODS, INC.,)	District of Indiana,
)	Indianapolis Division
Plaintiff-Appellant,)	
)	
v.)	No. 03-CV-0051
)	
ERNST & YOUNG LLP,)	
)	Hon. John D. Tinder,
Defendant-Appellee.)	<i>Judge, Presiding</i>

**BRIEF OF DEFENDANT-APPELLEE
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February 1, 2007

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CIRCUIT RULE 26.1 DISCLOSURE STATEMENT

Appellate Court No: 06-3366

Short Caption: Fehribach v. Ernst & Young LLP

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CIRCUIT RULE 26.1 DISCLOSURE STATEMENT

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CIRCUIT RULE 26.1 DISCLOSURE STATEMENT

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Short Caption: Fehribach v. Ernst & Young LLP

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AMENDED CIRCUIT RULE 26.1 DISCLOSURE STATEMENT

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Short Caption: Fehribach v. Ernst & Young LLP

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JURISDICTION

Plaintiff's jurisdictional summary is not complete and correct.

This case was brought by the Bankruptcy Trustee of Taurus Foods as an adversary proceeding in Taurus's Chapter 7 bankruptcy. R.1.¹ The district court withdrew the reference to the bankruptcy court in 2003. R.119-B. The district court had jurisdiction under 28 U.S.C. §§1331 and 1334.

On July 14, 2006, the district court granted summary judgment to Ernst & Young LLP ("E&Y") on both claims alleged by the Trustee. R.106-107; Pl. App. 7-11. The Trustee moved to alter or amend the judgment on July 28, 2006, which was denied on August 4, 2006. R.109, 112. The Trustee filed a notice of appeal on September 1, 2006. R.113. This Court has jurisdiction under 28 U.S.C. §1291. See *Bank of America v. Moglia*, 330 F.3d 942, 944 (7th Cir. 2003).

ISSUES

The Trustee's claims are based on the fact that E&Y's audit report on Taurus's fiscal year 1995 financial statements did not include a going concern statement. Such a statement would have indicated that there was substantial doubt that Taurus would continue as a going concern during the year after the period

¹ The plaintiff's brief is cited as "Pl. Br."; "Pl. App." refers to plaintiff's separate appendix. Other record materials are cited by district court docket number (e.g., "R.1"). Exhibits are referred to by docket number, followed by a hyphen with the exhibit letter and page number where applicable—e.g., R.57-C, at 214.

covered by the financial statements. As it turned out, Taurus remained in business for nearly three years after that date. The issues raised by this appeal are:

1. Whether the district court correctly held that the Trustee's claims were barred by Indiana's one-year statute of limitations when undisputed evidence shows that Taurus knew in 1996, more than a year before Taurus's 1998 bankruptcy, that its financial condition was so bad that it could not stay in business unless it defrauded its lender.

2. Whether the judgment should be affirmed on alternative grounds because:

a. The Trustee concedes—and the uncontested evidence shows—that economic and market factors caused Taurus to fail, not any act of E&Y;

b. There is no evidence that Taurus relied on the absence of a going concern statement in the 1995 audit report; and

c. The Trustee's deepening insolvency damages theory is inconsistent with Indiana law and injury to a bankrupt company cannot be measured by creditors' claims.

3. Whether, because Taurus's bankruptcy estate is supposedly indigent, the district court abused its discretion in awarding costs when the Trustee never made an indigency argument in the district court and never offered any evidence of indigency.

STATEMENT OF THE CASE

E&Y audited Taurus's 1995 financial statements, which covered the 12-month period ending January 28, 1995. R.106, at 2. The Trustee does not contend that the figures in the financial statements were incorrect in any way; he has admitted that "[t]he accuracy of the figures in the Taurus FY 1995 financial are not being challenged in this proceeding" (R.75, at 35), and his expert did not opine that the financial statements "are materially incorrect in any fashion" (R.57-F, at 106).

Rather, the Trustee asserts that E&Y's audit report should have added a "going concern" statement—that is, E&Y should have reported that there was substantial doubt that Taurus could continue to operate through the end of the next fiscal year (*i.e.*, up to January 28, 1996). Pl. App. 9-11; Pl. Br. 18 n.83 ("EY's negligence is that it failed to assess in its FY95 audit any SAS 59 'substantial doubt' about Taurus's ability to continue as a going concern and disclose the conditions").² The Trustee asserts that if E&Y had made a going concern statement in 1995, which would have informed Taurus of "the severity of its financial problems," Taurus could have liquidated its business in 1995 and 1996,

² The Trustee's expert also offered opinions on several other auditing standards, but these were all predicates to his going concern opinion. R.57-Q, at 8-16. The Trustee's appellate brief focuses entirely on the going concern issue. The only harm alleged by the Trustee purportedly flows from the absence of a going concern statement. *Id.* at 8; R.57-F, at 313-14, 356.

thus avoiding the losses that the company allegedly suffered later, when it went into bankruptcy in 1998. R.106, at 5-6.

The complaint alleges two claims concerning the 1995 audit: negligence and breach of contract. Pl. App. 7-11. After full discovery, E&Y raised several grounds for summary judgment.

Noting that E&Y's other arguments "may have merit" (R.106, at 15 n.6), the district court only needed to address the statute of limitations to grant summary judgment. It held that the Trustee's claims were barred by Indiana's Accountancy Act, which provides that claims must be brought within one year of when the alleged act or omission is discovered or should have been discovered. *Id.* at 7. The district court ruled that the claims were barred before Taurus's January 1998 bankruptcy because Taurus knew by fall 1996 "that there was a going concern issue." *Id.* at 10. That was when Taurus's Controller, Lisa Corry, began defrauding the bank that provided Taurus's financing because otherwise "Taurus would not be able to continue operations." *Id.* at 2, 12. Corry's knowledge, which was imputed to Taurus, was sufficient to "put her on notice that E&Y had possibly invaded some right of Taurus or that some claim might have existed against E&Y." *Id.* at 11, 13. The Trustee does not challenge the imputation ruling.

STATEMENT OF FACTS

A. Background. Taurus Foods distributed meats, frozen food, and canned items. R.57-A, at 32; R.57-B, at 1. Ronald Stein and Donald Wells each owned 50% of Taurus. R.57-A, at 29; R.57-C, at 21-22. Stein was the President, while Wells served as Executive Vice President, Secretary, and Treasurer. R.57-A, at 35, 37; R.57-D. The company's Controller, Vice President of Finance, and senior financial officer was Lisa Corry, a certified public accountant and Wells's daughter. R.57-A, at 39; R.57-C, at 15-17; R.84-C, at 113; R.57-D. Corry, who oversaw Taurus's in-house accounting staff, had worked for nearly five years as an auditor at a Big Eight firm, where she performed and supervised audits. R.57-C, at 15, 81-84.

Corry prepared, and was responsible for the accuracy of, Taurus's financial statements. *Id.* at 95. Taurus measured its financial results on fiscal years ending on the last Saturday in January. R.57-E, at 443. Taurus's 1995 fiscal year lasted from January 30, 1994 through January 28, 1995. *Id.*

B. E&Y's Audit Of Taurus's 1995 Financial Statements. Taurus engaged E&Y to audit the company's financial statements for its 1995 fiscal year; Taurus did not engage E&Y to be a business consultant or provide any other services. R.57-C, at 80-81, 91-94.

E&Y's audit report on Taurus's 1995 financial statement was dated August

4, 1995 and was issued in October 1995. R.57-E, at 436-38; R.57-G, at 129. E&Y delayed issuing a report until Taurus's lenders decided whether to waive Taurus's violations of certain loan covenants and Taurus provided E&Y with a management representation letter attesting to the accuracy of the information in the financial statements prepared by Taurus. R.57-G, at 113, 129; R.82-B, at 119-21; R.82-C, at 43-49; R.82-D.³

The audit report contained an "unqualified" opinion on Taurus's 1995 financial statements; it did not include a going concern qualification. R.57-E. A going concern statement is included in an audit report when the auditor concludes that there is "substantial doubt" about the company's ability to continue as a going concern for a reasonable period of time, "not to exceed one year" from the last day of the time period covered by the financial statement (January 28, 1995 for Taurus's 1995 financial statement). R.57-F, at 74-75, 283-84; R.84-F, at 278. An auditor's responsibility with respect to going concern statements is set forth in Statement on Auditing Standard No. 59 ("SAS 59"), which is issued by the Auditing Standards Board and has been codified as AU §341. R.57-F, at 60, 96. See Pl. App. 78-83 (copy of AU §341). A going concern analysis is based on the

³ Taurus received a draft 1995 audit report so it would be in a position to provide a client representation letter. Pl. App. 40. Contrary to the implication in the Trustee's brief (Pl. Br. 12), there is no evidence that Bank One ever received a draft of the 1995 audit report; the bank did not produce a copy in discovery, and no one testified that Taurus ever gave a draft to the bank.

auditor's evaluation of information supplied by company management. AU §341.02-.03 (Pl. App. 78-79).

There is no evidence that Taurus relied on the absence of a going concern qualification in the 1995 audit report. The Trustee's expert, Gary Fitzgerald, did not opine on whether Taurus relied on the audit report or on whether, if there had been a going concern qualification, Taurus would have shut down its business. R.57-F, at 356, 410. Taurus's co-owner, Donald Wells (Taurus's Rule 30(b)(6) witness), said that even if there had been a going concern statement, Taurus would not have decided to liquidate the business: "I wouldn't have done that. I would have said we'll do everything we can. ... And we're going to do everything to prove you wrong." R.57-A, at 179; R.57-H.

C. Taurus's Banking Relationship With Bank One. Taurus's principal lending relationship was with Bank One Indianapolis until May 1996, when the loan was transferred to an affiliate, Bank One Milwaukee. R.57-I, at 12; R.84-I, at 16. The loan was transferred in May 1996—15 months after the end of Taurus's 1995 fiscal year—because Bank One Indianapolis decided it was not satisfied with Taurus's financial performance; Bank One's Milwaukee affiliate had an asset-based lending group, which was structured to handle riskier loans. R.57-I, at 23; R.57-J, at 12. As a result, Bank One Milwaukee was able to (and did) impose greater controls over Taurus and monitor the collateral more closely after

May 1996. R.57-I, at 26-27. After the loan transfer, the bank required Taurus to submit interim, unaudited four-week financial statements and daily reports of inventory and accounts receivable balances. R.57-C, at 66-67; R.57-A, at 44-45, 171-72; R.57-B, at 2. The bank also increased the interest rate on Taurus's loans and revised the borrowing formula, reducing Taurus's ability to borrow. R.57-C, at 66-67, 212; R.57-A, at 171-72; R.57-B, at 2.

Starting in the fall of 1996, Bank One was the victim of a fraud perpetrated by Lisa Corry, who provided the bank with false information so that Taurus could continue to borrow money. When the bank learned of the fraud in the fall of 1997, it refused to make any more loans. R.57-A, at 162. Taurus remained in business until January 5, 1998, when three Taurus creditors filed an involuntary Chapter 7 bankruptcy petition. *Id.* at 114-15; R.57-K.

D. Lisa Corry's Fraud And Taurus's Knowledge Of Its Own Financial Condition. Taurus's upper management knew by no later than the fall of 1996 that the company had dire financial problems. Lisa Corry, Taurus's senior financial officer, was "intimately familiar" with Taurus's finances. R.84-C, at 43. By fall 1996, Corry knew that Taurus was experiencing a "desperate cash crisis." R.57-L, at 65. The company's finances were so dire that Corry began defrauding Bank One by submitting false information about Taurus's sales and accounts receivable in order to induce the bank to continue making loans to Taurus; Corry

believed that this was the only way to pay Taurus's bills and "keep[] the company afloat." R.57-C, at 150-52, 157, 181, 184, 213, 227-28; R.57-A, at 102-03; R.57-L, at 66-67. Starting in the fall of 1996, Corry "consistently" gave the bank "falsified" information, but by the summer of 1997, Corry realized that Taurus's problems couldn't be "fix[ed]." R.57-C, at 150-51, 209. Corry then told Wells she "had been keeping the company afloat by creating fictitious sales." *Id.* at 181. Corry later pled guilty to bank fraud charges. *United States v. Corry*, 206 F.3d 748 (7th Cir. 2000).

Although Wells and Stein did not know of Corry's fraud in 1996, both were aware of Taurus's desperate financial situation. Taurus never had more than 100 employees, and Wells and Stein were "hands on" managers: they were involved in the details of the company's daily operations; they reviewed Taurus's interim unaudited financial statements every four weeks; and Corry regularly talked with them about Taurus's financial condition. R.57-C, at 16-17, 37, 65, 242; R.84-C, at 38-43, 50-52; R.57-A, at 53, 67-71; R.57-B, at 3. Corry and Wells testified that before the end of 1996, Corry had several discussions with Stein and Wells about (1) Taurus's "declining sales," "increasing" expenses, "eroding" margins, and cash flow problems; (2) reports showing variances between Taurus's budget and its actual performance; (3) the factors causing changes or fluctuations in Taurus's financial results; and (4) how to "solve the problem." R.57-C, at 33-34, 131-32,

213-14, 238; R.84-C, at 41; R.57-A, at 69-71.

Wells, Stein, and Corry talked regularly with Bank One about Taurus's financial problems. In 1996, Taurus had discussions with Bank One about the "declining trend" in Taurus's net sales and Taurus's non-compliance with existing loan covenants. R.57-C, at 129; R.57-I, at 64-65, 86; R.57-M, N. Corry testified that when Bank One moved Taurus's loan to its asset-based lending group in Milwaukee in May 1996, it was "intuitively obvious" that the bank thought there were "financial problems" because it thought the loan was "too high risk." R.57-C, at 214-15; R.57-I, at 12. The bank told Wells and Stein that the loan was moved because of Taurus's financial performance. R.57-C, at 215-16.

When Wells attempted to sell the company in the summer of 1996, the prospective buyer lost interest after reviewing Taurus's financial data. R.57-C, at 240-42; R.57-A, at 197-202; R.57-B, at 3. Wells knew at the time that Taurus's debt was too high and its margins were too low. R.57-A, at 199.

E. The Causes Of The Alleged Losses. The Trustee's expert did not offer an opinion that E&Y (or any other entity) caused any of Taurus's alleged losses. R.57-F, at 329, 331, 333, 344-45. Wells and Corry were the only ones to testify on this issue, but neither said that E&Y's failure to include a going concern statement in the 1995 audit report caused Taurus to go out of business and not pay

its creditors. Rather, they identified many other reasons why Taurus ultimately failed:

- As of May 1996, there were higher interest rates on Taurus's loans from Bank One, which concluded that Taurus presented more risk due to its poor financial performance, and a revised borrowing formula that reduced Taurus's ability to borrow.
- Severe cash-flow problems beginning in the early fall of 1996, resulting from decreasing sales and shrinking profit margins.
- Further increased competition from national distributors.
- The loss of major customers.
- Decreasing profit margins throughout the food industry.
- The loss of key sales personnel.
- A doubling of the company's workers' compensation premiums.
- Very large increased expenses for Taurus's self-funded health insurance plan.
- Increasing payments on industrial revenue bonds that had been used to finance the construction of a new facility. That facility was built to handle anticipated exports to the Netherlands, which never materialized because of a European ban on importing hormone-fed beef.
- A costly, unsuccessful anti-union campaign.
- The death of Taurus's President and CEO, Jim Wiesen.

R.57-C, at 116, 212-15, 229-38; R.57-A, at 147-48, 151-59; R.57-B, at 1-3; R.57-I, at 23-25; R.57-J, at 12. There was no other evidence concerning the reasons for

Taurus's demise and the non-payment of creditors.

F. The Trustee's Expert. Gary Fitzgerald testified as an expert for the Trustee. On liability, Fitzgerald testified that a "restructuring of debt" directly implicates the going concern analysis. R.57-F, at 74, 168; R.84-F, at 78, 167, 203-05. In addition, Fitzgerald stated that after the maximum 12-month going concern period expires—that is, after January 28, 1996 for the 1995 audit report—the going concern issue is "moot." R.57-F, at 422. An auditor is not "responsible to try to project or determine" what might happen after that 12-month period. *Id.* at 419, 423-24. Accordingly, the absence of a going concern qualification does not indicate anything about a company's ability to continue as a going concern for more than 12 months. *Id.* at 418.⁴

Fitzgerald's damages calculations assumed that Taurus would have promptly liquidated itself had there been a going concern statement in the 1995 audit report. R.57-F, at 308; R.57-O, ¶ 2. He did not have a damages calculation that assumed that Taurus remained in business or restructured its debts. R.57-F, at 337-41, 346-52. Fitzgerald's damages figure had two components.

⁴ In the district court, E&Y argued that Fitzgerald's going concern opinion was inadmissible because his methodology violated recognized professional standards. R.59, 85. E&Y does not raise that issue now for reasons of space and because the district court did not reach it, but admissions in the Trustee's appellate brief—that in 1995 Taurus was profitable, had a net worth exceeding \$1 million, and had never experienced significant cash flow problems (Pl. Br. 8, 13)—strongly suggest that there was no basis for a going concern statement in 1995.

First, Fitzgerald concluded that Taurus “could have avoided” unpaid bills from some of its creditors. R.57-F, at 308, 314, 400. Fitzgerald calculated this amount by adding up \$2.973 million in unpaid creditors’ claims asserted in Taurus’s bankruptcy. *Id.* at 303, 387, 392-94, 405, 407; R.57-O, at 4-5. Fitzgerald testified, however, that Taurus “isn’t out that \$3 million” because it “hasn’t paid” it and that Taurus was not damaged by receiving “things of value” for which it “had not yet paid”; any damage was suffered by “the people to whom the money is owed.” R.57-F, at 405-07. Fitzgerald further testified that under general bankruptcy principles, “Taurus won’t have to pay those unpaid debts” and that a company “benefit[s]” when an unpaid liability is “forgiven” and “taken off the books.” *Id.* at 408-09, 444.

Second, Fitzgerald calculated that Taurus had incurred \$185,000 in expenses and costs during its bankruptcy. R.57-O, at 5. Fitzgerald also testified that the liquidation that he assumed would have happened if the 1995 audit report had included a going concern statement would have involved costs of \$250,000. R.57-F, at 368-71.

STANDARD OF REVIEW

Summary judgment rulings are reviewed *de novo*. *McCoy v. Harrison*, 341 F.3d 600, 604 (7th Cir. 2003). Courts “‘are not required to draw every conceivable inference from the record,’ and ‘mere speculation or conjecture’ will not defeat a

summary judgment motion.” *Id.* (citation omitted). The movant is entitled to judgment when “the nonmoving party, who bears the burden of proof, has failed to make a sufficient showing on an essential element of the case.” *Id.*

SUMMARY OF ARGUMENT

The Trustee has never contended that even a single number in Taurus’s 1995 financial statements is wrong. His claims are based solely on the theory that E&Y’s 1995 audit report should have added a going concern statement reporting that there was substantial doubt that Taurus would continue to operate for one year after January 28, 1995, the end of the period covered by the 1995 audit. If E&Y had done that, the Trustee asserts, Taurus would have quickly liquidated its business, thus avoiding the losses it allegedly suffered later, when it went into bankruptcy in 1998.

Thus, the Trustee contends essentially that E&Y, the outside auditor, should have told Taurus and its management, the people actually running the business, that the company was having immediate business problems, based on accurate figures that each possessed. Not only does this theory make no sense, but members of Taurus’s management indisputably knew no later than the fall of 1996 what a going concern statement would have indicated—namely, that there was substantial doubt whether Taurus could stay in business. By then, Taurus’s situation was so bleak that Taurus’s senior financial officer, Lisa Corry, began

defrauding Taurus's principal lender because that was the only way Taurus could continue to operate. Since Taurus knew about its grave problems in the fall of 1996, it should have inquired whether its auditors should have alerted it to the problems the year before. Under Indiana precedent, Taurus's knowledge in the fall of 1996 triggered the one-year statute of limitations for claims against accountants, which thus expired in the fall of 1997, before the January 1998 bankruptcy filing.

Even if the claims were timely, they are meritless. There is not the slightest evidence that the absence of a going concern statement in the 1995 audit report caused the losses alleged by the Trustee; on the contrary, undisputed evidence establishes that Taurus eventually failed and did not pay creditors because of Corry's fraud and a host of general business and economic factors that had nothing to do with E&Y's audit report. The Trustee's appellate brief repeatedly admits that Taurus's demise was caused by other, unrelated factors. Furthermore, Taurus continued in business for nearly two years *after* the going concern issue became, as the Trustee's expert admitted, "moot." Liability cannot be based on the failure to include a going concern qualification when the company is still a going concern more than 12 months after the period covered by the audit.

Nor is there any evidence of reliance. The Trustee contends that had there been a going concern statement in 1995, Taurus would have decided to shut down. But no evidence supports that hypothesis. In fact, Taurus's co-owner and Rule

30(b)(6) witness, Donald Wells, testified flatly that Taurus would *not* have closed its doors had there been a going concern statement in the 1995 audit report.

There is also no evidence of damages. The Trustee did not offer evidence to satisfy Indiana's measure of damages (the company's diminished value). Instead, he proceeded on a deepening insolvency theory of harm. That theory does not make economic sense, is inconsistent with Indiana precedent, and does not apply in negligence cases. Even if the theory applied, the Trustee's expert admitted that the losses suffered *by unpaid creditors* did not harm *Taurus*, whose debts will be extinguished in bankruptcy.

Finally, the Trustee asserts that the district court abused its discretion in imposing costs because Taurus's bankruptcy estate is purportedly indigent. The Trustee waived this argument because he never made it below and never offered any evidence of indigency. In any event, this Court has held several times that costs may be imposed on indigent parties.

ARGUMENT

I. The Statute Of Limitations Bars The Trustee's Claims Because Taurus Was On Notice Of A Possible Claim Against E&Y Before January 5, 1997.

Taurus's involuntary bankruptcy petition was filed on January 5, 1998, and the bankruptcy court entered the order for relief on February 19, 1998. *In re Taurus Foods*, No. 98-00071, Dkt. Nos. 1, 9 (Bankr. S.D. Ind). A bankruptcy

trustee has two years from the latter date to sue, but only if the limitations period “has not expired before the date of the filing of the petition.” 11 U.S.C. §108(a). If the limitations period expired before the bankruptcy, the claim is barred.

As explained in detail below, the district court properly concluded that “Taurus had knowledge of the pertinent facts by the fall of 1996.” R.106, at 15. That “trigger[ed] the commencement of [Indiana’s] one-year statute of limitations,” which thus expired before the January 1998 bankruptcy filing. *Id.*

A. Notice Of Negligence Is Not Required To Trigger The Statute Of Limitations.

Indiana’s Accountancy Act has a one-year limitations period for negligence and contract claims against accountants. For any action “based on negligence or breach of contract brought against an accountant” arising out of an audit (Ind. Code §25-2.1-15-1), suit “must be commenced” within “[o]ne (1) year from the date the alleged act, omission, or neglect is discovered or should have been discovered by the exercise of reasonable diligence” (Ind. Code §25-2.1-15-2(1)). It has never been disputed that the Trustee’s claims (negligence and breach of contract, Pl. App. 9-11) are covered by the statute.

The Trustee does not discuss the text of the Accountancy Act, completely ignores the cases applying that statute, and does not mention the key legal standards discussed in *Perryman v. Motorist Mutual Insurance*, 846 N.E.2d 683 (Ind. Ct. App. 2006), on which the district court relied extensively. R.106, at 9, 13;

R.112, at 4-5. These omissions are telling.

The Trustee contends that the limitations period does not begin running until the plaintiff knows or should know that the defendant acted tortiously. Pl. Br. 22-25. That is not what the statute says; it does not give a plaintiff the luxury of waiting until the plaintiff decides that the defendant acted negligently. Rather, the Accountancy Act provides that negligence and contract claims against accountants must be brought within one year “from the date the *alleged act, omission, or neglect* is discovered or should have been discovered by the exercise of reasonable diligence.” Ind. Code §25-2.1-15-2(1) (emphasis added). The statute is triggered by discovery of the alleged act or omission, not by a later characterization of that conduct as negligent.

Indiana courts have agreed uniformly that, under the Accountancy Act, “discovery of a cause of action is *not required* in order to commence the running of the statute of limitations.” *Heaton & Eadie Prof’l Servs. Corp. v. Corneal Consultants*, 841 N.E.2d 1181, 1188 (Ind. Ct. App. 2006) (emphasis added). “Rather, discovery of acts, omissions or neglect underlying the claim, or those that should have been discovered with the exercise of reasonable diligence, trigger the statute.” *Id.* Thus, Indiana has rejected the argument that the limitations period in the Accountancy Act “is tolled until [the client] discovered the Accountants’ negligence.” *Bambi’s Roofing v. Moriarty*, 859 N.E.2d 347, 351 (Ind. Ct. App.

2006) (affirming summary judgment for the accountants). As *Bambi's Roofing* notes, “the discovery rule only postpones the statute of limitations by belated discovery of key facts, not by delayed discovery of legal theories.” *Id.* at 356 (citing *Perryman*, 846 N.E.2d at 689). Moreover, the *Bambi's Roofing* court held, the discovery rule “merely anticipates that a plaintiff be possessed of sufficient information to cause him to *inquire further* in order to determine whether a legal wrong has occurred.” 859 N.E.2d at 356 (emphasis added; citing *Perryman*). See also *Crowe, Chizek & Co. v. Oil Technology*, 771 N.E.2d 1203, 1205, 1207, 1209 (Ind. Ct. App. 2002) (one-year Accountancy Act limitations period began when client had “an opportunity” to discover in 1993 that it qualified for a property tax exemption that its outside accountants did not claim, even though the client “first became aware of this exemption” in 1997).

Well before these recent Indiana cases, this Court rejected the contention that the Indiana discovery rule is postponed until the plaintiff learns that the defendant acted negligently. See *Frey v. Bank One*, 91 F.3d 45, 47 (7th Cir. 1996) (“Indiana does not require that a plaintiff uncover the legal theory for holding a defendant liable for the action to accrue”; the argument that a limitations period did not begin until the plaintiff knew that a bank “had handled his account negligently ... misstates the law of Indiana”).

If the limitations period were delayed until the plaintiff concluded that the defendant's conduct was negligent, the statute would be a dead letter and would almost never run in cases against accountants. That is not Indiana law. To the contrary, Indiana courts are "in favor of statutes of limitations" and "are inclined to construe limitations laws liberally." *Shideler v. Dwyer*, 417 N.E.2d 281, 283 (Ind. 1981).

The Accountancy Act begins running when the client knew or should have been put on notice of the accountant's alleged omission and that the purported omission caused an injury. As discussed next, Taurus knew those things no later than the fall of 1996.

B. Taurus Knew In 1996 Of The Adverse Financial Conditions That Would Have Been Indicated By A Going Concern Statement.

A going concern statement in an audit report is significant because of what it indicates about a company's financial condition—that there is "substantial doubt" that it will remain a going concern during the next year. AU §341.02 (Pl. App. 78). But when a company was already aware that it was in "desperate financial straits," then "a going concern qualification would only have disclosed to [the company] that which it already knew." *Devaney v. Chester*, 1989 WL 52375, at *4-*5 (S.D.N.Y. May 10, 1989).

Accordingly, when a claim is based on the theory that an auditor should have made a going concern statement, the limitations period begins running no

later than when the plaintiff was put on notice of the company's desperate financial straits or its inability to meet its financial obligations in the ordinary course. See *Pew v. Cardarelli*, 2005 WL 3817472, at *14 (N.D.N.Y. Mar. 17, 2005) (limitations period on investors' claim that audit report should have included a going concern statement began when "plaintiffs were made aware of the factual circumstances bearing on [the company's] financial situation"), *aff'd*, 164 Fed. Appx. 41 (2d Cir. 2006). See also *Jackson Nat'l Life Ins. v. Merrill Lynch & Co.*, 32 F.3d 697, 703 (2d Cir. 1994) (plaintiff was put "on notice that Insilco's earlier opinion about its ability to continue as a going concern was being eviscerated by later events" when plaintiff, 16 months later, learned "that the company was experiencing severe cash flow problems that might render it unable to meet its current liabilities").

Here, the Trustee contends that a going concern statement, if included in the 1995 audit report, would have notified Taurus of "the severity of its financial problems" (R.106, at 6) and "the true effects of Taurus's financial situation" (Pl. Br. 2). As the Trustee told the district court, a going concern statement "would have highlighted Taurus' economic problems." R.75, at 23. But if Taurus knew or should have known before January 5, 1997, one year before the bankruptcy petition, that it "was no longer able to meet its obligations" (R.106, at 10), then its claims are untimely.

Taurus did know. Taurus's Controller, Vice President of Finance, and senior financial officer was Lisa Corry, a CPA who had worked as an auditor for nearly five years. R.57-C, at 15-16, 81-84; R.84-C, at 113; R.57-A, at 39. Corry, the daughter of Taurus co-owner Donald Wells, prepared Taurus's financial statements and was "intimately familiar" with Taurus's finances. R.57-C, at 17, 95; R.84-C, at 43.⁵

By the fall of 1996, Corry concluded that Taurus's financial picture was so bleak that she began falsifying Taurus's accounts receivable and sales figures in order to defraud Bank One into continuing to make loans to Taurus so that Taurus could pay its bills; she believed that was the only way to "keep[] the company afloat." R.57-C, at 150-52, 157, 181, 184, 213, 227-28; R.57-L, at 66. At that point, she knew that Taurus was experiencing a "desperate cash crisis" and "wouldn't have money to pay [its] vendors" unless the bank was defrauded into providing the additional cash "needed to operate the business." R.57-C, at 227-28; R.57-L, at 65; see also R.57-C, at 209, 212-13. Declining sales, shrinking margins,

⁵ The Trustee does not challenge the district court's correct ruling that "the knowledge that Corry acquired while acting in the course of her employment at Taurus is imputed to Taurus" (and hence to the Trustee). R.106, at 11. See *Mid-Continent Paper Converters v. Brady, Ware & Schoenfeld*, 715 N.E.2d 906, 909-13 (Ind. Ct. App. 1999) (when a company's vice president of finance falsified financial records to obtain new bank loans "necessary for the survival of the company," his knowledge of the fraud was imputed to the company in a case it brought against its auditors); *Reagan v. First Nat'l Bank*, 61 N.E. 575, 582 (Ind. 1901) (financial manager's knowledge of the company's "insolvent condition ... must be imputed to the company").

and more onerous debt terms with Bank One all limited the amount of money that Taurus could borrow. *Id.* at 209, 212-13, 227-28. In short, it is undisputed that Corry knew, in the fall of 1996, that Taurus could not stay in business without engaging in fraud. Pl. Br. 4 (Corry “inflated certain accounts to be able to borrow more funds to continue operations”).

It does not matter that Corry “hope[d]” in 1996 that the fraud would be short-lived. Pl. Br. 17 n.82. Corry testified unequivocally that Taurus’s financial condition in the fall of 1996 was so dire that unless she had committed fraud for the company, Taurus would not have been able to obtain the cash it needed to run the business. From then on, she consistently sent the bank phony information. R.57-C, at 151. It is undisputed that a business will not remain a going concern if it cannot “continue to meet its obligations as they become due.” Pl. Br. 6. By Corry’s own admission, Taurus could no longer do that in the fall of 1996 unless it resorted to fraud. When the Controller knows that the company cannot pay its bills without committing fraud, there is obviously a going concern issue. As the district court noted, the fact that things were so bad that Corry had to commit fraud to keep Taurus going should have prompted Corry to inquire into the auditors’ actions “and question[] whether the company would have been in the same situation had E&Y alerted it to a going concern issue the year before.” R.106, at 14 n.4. Indeed, the district court pointed out, “this is the same basic analysis that the Plaintiff

Trustee went through prior to bringing the current action.” *Id.*

Although Corry hid her fraud from her father and Ron Stein (Taurus’s other co-owner) until 1997 (R.57-C, at 158), Wells and Stein were both also indisputably aware of Taurus’s deteriorating and desperate financial situation by the end of 1996. Under general imputation principles, their knowledge is also attributed to Taurus. *Madison County Bank v. Kreegar*, 514 N.E.2d 279, 281 (Ind. 1987) (“the knowledge of an agent acquired while acting in the course of employment will be imputed to the corporation”).

Wells and Stein were “hands on” managers who were intimately involved in Taurus’s day-to-day operations, always reviewed Taurus’s interim monthly financial statements, and regularly discussed the company’s financial condition with Corry. R.57-C, at 16-17, 37, 65, 242; R.84-C, at 38-43, 50-52; R.57-A, at 53, 67-71; R.57-B, at 3. Wells was well aware of the business factors that affected Taurus’s profitability, and he knew in 1996 that Taurus had “a lot of debt, and low margins.” R.57-A, at 147-48, 151-59, 199; R.57-B, at 1-3. Before the end of 1996, Corry had a number of discussions with Stein and Wells about (a) Taurus’s “declining sales,” “increasing” expenses, “eroding” margins, and cash flow problems; (b) budget-to-actual reports showing variances between Taurus’s budget and its actual performance; (c) the factors that they thought were causing changes or fluctuations in Taurus’s financial results; and (d) how to “solve the problem.”

R.57-C, at 33-34, 131-32, 213-14, 238; R.84-C, at 41; R.57-A, at 69-71.

In addition, Taurus officials had discussions with Bank One in 1996 about the “declining trend” in the company’s net sales and its non-compliance with existing loan covenants. R.57-C, at 129; R.57-I, at 64-65; R.84-I, at 86; R.57-M, N. And when, in May 1996, Bank One moved Taurus’s loan to its asset-based lending group in Milwaukee, Corry admitted that it was “intuitively obvious” that there were “financial problems” and that Bank One had concluded that the existing loan was “too high risk.” R.57-C, at 214-15; R.57-I, at 12. Wells and Stein participated in meetings in which the bank explained that the loan was moved because of Taurus’s financial performance. R.57-C, at 215-16. Moreover, the changes in the Bank One loan involved a “restructuring of debt” and a “new ... method[] of financing”—a type of change that can “indicate there could be substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time.” AU §341.06 (Pl. App. 80).

After the May 1996 loan restructuring, Bank One increased the interest rate on the loan, reduced Taurus’s ability to borrow, and required Taurus to send the bank interim, unaudited four-week financial statements, as well as daily reports showing its inventory and accounts receivable balances. R.57-C, at 66-67, 212; R.57-A, at 44-45, 171-72; R.57-B, at 2. The Trustee admits that “after the new lending arrangement in May, 1996 ... Taurus began to suffer such severe cash flow

problems” that it “did not have the funds to pay its obligations as they became due.” Pl. Br. 15. By definition, this indicates a going concern problem. Pl. Br. 6 (going concern is defined “in terms of a business’s ability to continue to meet its obligations as they become due”).

Because of what Corry, Wells, and Stein knew, Taurus, before the end of 1996, knew or “should have” discovered “by the exercise of reasonable diligence,” Ind. Code §25-2.1-15-2(1), that it had dire financial problems. Most importantly, Taurus (through Lisa Corry) knew, at least by the fall of 1996, that its financial condition was so dismal that it could not meet its existing obligations and stay in business without defrauding its lenders. Additionally, the Trustee’s expert admitted that a “restructuring of debt” directly implicates going concern issues, and Corry acknowledged that the loan restructuring indicated “obvious” financial problems. R.57-F, at 74, 168; R.84-F, at 78, 167, 203-05; R.57-C, at 214-15. The other evidence discussed above also shows that Taurus had actual knowledge (and certainly constructive knowledge through its own records) of its shaky financial position by the fall of 1996 at the latest.

In short, undisputed evidence shows, as the district court concluded, that Taurus was well aware in fall 1996 that it “was no longer able to meet its obligations.” R.106, at 14. Because that is what a going concern statement would have indicated, the company’s knowledge was easily enough to put Taurus on

notice of the need to inquire into potential claims against its auditor, thus triggering the one-year limitations period. In so holding, the district court did not “rewrite official AICPA standards,” Pl. Br. 28, but simply applied Indiana’s discovery rule in a manner that is fully consistent with existing precedent, as it explained in denying reconsideration, R.112, at 4.

For example, in *Bambi’s Roofing*, the limitations period for a claim against a company’s accountants began “at the moment” the company discovered an employee’s embezzlement—that discovery “reasonably put them on notice that *some claim might exist* against the Accountants.” 859 N.E.2d at 356 (emphasis added). Similarly, *Crowe, Chizek* held that a corporation’s claim against an accounting firm for failing to claim a property tax exemption accrued when the company’s employees began completing the tax form, had “[a]n opportunity ... to discover that its property qualified for a tax exemption,” and therefore “should have discovered” the accountant’s omission. 771 N.E.2d at 1207, 1209. See also *Lakeside, Inc. v. DeMetz*, 621 N.E.2d 1149, 1152 (Ind. Ct. App. 1993) (claim time-barred where “a diligent reading” of a document would have revealed the allegedly negligent omission).

Given that the one-year period in the Accountancy Act begins “at the moment” a client learns of employee embezzlement, *Bambi’s Roofing*, 859 N.E.2d at 356, or when the client has an “opportunity” to discover a tax problem, *Crowe*,

Chizek, 771 N.E.2d at 1209, the statute must also start running when the senior financial officer knows the company has to defraud its lender to keep its business operating—as Lisa Corry knew in the fall of 1996.⁶ And having started running then, the one-year period expired in the fall of 1997, before the January 1998 bankruptcy filing.

C. Taurus Knew Of Its Alleged Injury In The Fall Of 1996.

The Trustee claims that Taurus “had no knowledge of any ‘injury’ connected to its economic deterioration in the fall, 1996.” Pl. Br. 25. That is not correct. The “injury” was that Taurus was in dire financial straits—*e.g.*, it could only survive by embarking on a scheme to defraud its lender in order to receive additional loans to prop itself up—and E&Y had not previously given a going concern statement in its audit report. See R.106, at 14; *Bambi’s Roofing*, 859 N.E.2d at 356 (statute begins when plaintiff has information that should cause him to inquire “whether a legal wrong has occurred”); *Pew*, 2005 WL 3817472, at *16 (statute triggered when plaintiffs were on inquiry notice “of the risk” of company’s “deteriorating condition and the risk that [it] would be unable to meet its obligations”). Corry knew this—that was why she began defrauding Bank One in

⁶ As Controller, Corry knew much more than the investors knew in *Pew*, where the court held, in a case involving a failure to include a going concern statement, that the limitations period began when the investors became aware of facts concerning the company’s finances, including its poor performance, breach of loan covenants, negative cash flow, and more onerous credit terms. 2005 WL 3817472, at *14.

the first place.

In a similar vein, the Trustee asserts that Taurus was not losing money on a “continual” basis and that the district court ignored contrary evidence in concluding otherwise. Pl. Br. 20-21. Lisa Corry testified that the May 1996 loan restructuring indicated “obvious ... financial problems.” R.57-C, at 215. But even putting that aside, the Trustee has misconstrued what the district court said. The court’s opinion states: “*by the fall of 1996*, Corry had knowledge of the following pertinent facts: ... 3) that Taurus was losing money and value on a continual basis.” R.106, at 12 (emphasis added). Regardless of when the losses started, it is indisputable that “by the fall of 1996,” they were “continual.” *Id.* Again, that’s why Corry began defrauding the bank. It was the only way the company could survive. Corry knew that without committing fraud, Taurus could not pay its bills and continue operating. R.57-C, at 227-28.

In any event, Indiana does not require that a loss be “continual” to start the statute of limitations: “the discovery of *an* injury ... commences the running of the statute of limitations.” *Perryman*, 846 N.E.2d at 690 (emphasis added). “For a wrongful act to give rise to a cause of action and thus to commence the running of the statute of limitations, it is not necessary that the extent of the damage be known or ascertainable but only that damage has occurred.” *Shideler*, 417 N.E.2d at 289. Taurus knew of its alleged injury by the fall of 1996.

D. Later Events Put A Plaintiff On Notice Of An Earlier Going Concern Issue.

The Trustee also contends that Taurus's inability to continue as a going concern in the fall of 1996 without breaking the law did not put it on notice that the audit report for the 12 months ended January 28, 1995 should have included a going concern qualification. Pl. Br. 26-28. Because Taurus's economic problems did not arise until after the 12-month period expired, the Trustee argues that "[t]he reasons for Taurus's economic problems" in the fall of 1996—"a combination of its new loan terms and traditional economic issues"—gave it "no reason to be put on notice that it was 'injured'" by the 1995 audit opinion. *Id.* at 26. There are several problems with this argument.

For one thing, to trigger the statute of limitations "[t]here is no requirement that the plaintiff link the injury to a wrongful act, only that ordinary diligence could have discovered such a link." *Frey*, 91 F.3d at 47 (applying Indiana law). See also *Horn v. A.O. Smith Corp.*, 50 F.3d 1365, 1371 (7th Cir. 1995) (Indiana statute of limitations barred plaintiffs' claims; even though "they did not link their problems to the Harvestore silos" before 1991, "by 1983, the Horns at least should have investigated the silos as a possible source of their problems").

The facts here should have prompted Taurus to investigate a possible claim against E&Y in the fall of 1996. As other courts have held, later-acquired information about a company's poor financial condition puts a plaintiff on notice

that it should investigate a potential claim that the defendant should have made a going concern statement at an earlier date—and therefore begins the statute of limitations. See *Jackson*, 32 F.3d at 703 (adverse financial information in May 1990 triggered the limitations period because it put plaintiff on notice of a potential claim concerning an opinion given in February 1989 about continuing as a going concern); *Pew*, 2005 WL 3817472, at *9, *14, *16 (information about the company’s finances received in March 2002 put plaintiffs on notice of possible claims based on auditor’s failure to make a going concern statement for the periods ending June 2000 and June 2001).

Jackson and *Pew* demonstrate that the Trustee is incorrect in taking the view that later events cannot put one on notice of a possible claim for an earlier year—a position none of the Trustee’s cases support. *Crowe, Chizek* confirms the point. The Indiana Court of Appeals held there that the client’s opportunity in 1993, 1994, and 1995 to discover its prior accountant’s omissions in filling out tax forms was sufficient to begin the limitations period for possible claims against the accountant concerning tax forms prepared by the accountant in 1992 and earlier. 771 N.E.2d at 1207, 1209.

Indeed, for the limitations period to have any meaning in going concern cases, subsequent events *must* be considered. As the district court noted, a reasonable person learning that a company could no longer operate as a going

concern would necessarily “look back and question how the company arrived in this situation” and ask whether “the company would have been in the same situation had [the auditor] alerted it to a going concern issue the year before.” R.106, at 14 & n.4. Moreover, as explained later (at 40-43), if a company does not fail within the 12-month period covered by a possible going concern statement, there is no claim at all. But if there is a claim in that situation, it would, by definition, *have* to be based on events occurring *after* the 12 months have expired. Yet the Trustee argues that while those events can be the basis for a claim, they cannot trigger the limitations period. That would make the statute of limitations a nullity. The Trustee cannot have it both ways; courts routinely reject arguments of the heads-I-win, tails-you-lose variety. *E.g.*, *Kaskel v. Northern Trust Co.*, 328 F.3d 358, 360 (7th Cir. 2003); *Tregenza v. Great American Communications*, 12 F.3d 717, 722 (7th Cir. 1993).

There is a final problem with the Trustee’s position. If the events of 1996 did not trigger the limitations period because they have “no inherent connection with” the 1995 audit (Pl. Br. 18), then that audit could not possibly have caused Taurus’s alleged losses: the creditors’ claims that went unpaid as Taurus’s business went south, finally ending in bankruptcy in 1998. That topic is discussed next, as the first alternative ground for affirmance.

II. There Are Compelling Alternative Grounds For Affirmance.⁷

A. The Trustee Cannot Establish The Essential Element Of Causation.

1. The Trustee cannot recover for losses caused by market forces.

Causation is, of course, an essential element of the Trustee's claims. The governing legal principles are well settled. To prove breach of contract, the plaintiff must prove "that the breach was the cause in fact of its loss." *Thor Elec. v. Oberle & Assocs.*, 741 N.E.2d 373, 381 (Ind. Ct. App. 2000). Similarly, a negligence claim requires proof that "the plaintiff suffered compensable injury that was proximately caused by the defendant's breach." *Gates v. Riley*, 723 N.E.2d 946, 950 (Ind. Ct. App. 2000). Whatever the claim, Indiana defines "the proximate cause of an injury" as "that cause which in natural and continuous sequence, *unbroken by any efficient intervening cause*, produces the result complained of and without which the result would not have occurred.'" *Id.* (emphasis added; quoting *Hill v. Beghin*, 644 N.E.2d 893, 896 (Ind. Ct. App. 1994)). And "evidence establishing a mere possibility of cause or which lacks reasonable certainty or probability is not sufficient evidence by itself." *Daub v. Daub*, 629 N.E.2d 873, 877 (Ind. Ct. App. 1994).

⁷ The arguments presented next—on causation, reliance, and damages (pp. 33-54)—are alternative grounds for affirmance raised below but not reached by the district court. See *Tricontinental Industries v. PricewaterhouseCoopers*, 2007 WL 102985, at *7 (7th Cir. Jan. 17, 2007).

In particular, when the plaintiff alleges “that accurate audits would have prompted company action to cure or mitigate the company’s basic economic problems,” the plaintiff must prove “that correct accountancy would have averted” the harms alleged. *Drabkin v. Alexander Grant & Co.*, 905 F.2d 453, 455 (D.C. Cir. 1990). If the harm would have occurred anyway—if the company failed for business reasons, not because of an allegedly flawed audit—the auditor is not liable. *Id.* at 455-58. “A defendant who is clearly not responsible for a harm should not have to pay for it.” *Id.* at 457. See also *Devaney*, 1989 WL 52375, at *6 (an auditor’s failure to include a going concern qualification did not cause the plaintiffs’ losses—they would have purchased the company anyway; the company later filed for bankruptcy because new management could not make a profit).

Drabkin and *Devaney* illustrate the established rule that a plaintiff cannot recover for “a loss caused by extraneous economic conditions.” *Movitz v. First Nat’l Bank*, 148 F.3d 760, 765 (7th Cir. 1998) (holding that the plaintiff’s losses were caused by the collapse of the Houston real estate market, not by the defendant’s negligent evaluation of the Houston office building in which the plaintiff had invested). If the alleged injury was not caused by the defendant, but by “industry-wide phenomena,” then “any award of damages to [the plaintiff] would be a windfall.” *Bastian v. Petren Resources Corp.*, 892 F.2d 680, 684-85

(7th Cir. 1990).⁸ See also *Tricontinental*, 2007 WL 102985, at *15 (“To plead loss causation, the plaintiff must allege that it was the very facts about which the defendant lied which caused its injuries”); *Johnson Bank v. George Korbakes & Co.*, 472 F.3d 439, 443 (7th Cir. 2006) (the bank’s decision to lend additional money—which caused its losses—“had nothing to do with the audit”).

2. E&Y did not cause Taurus’s alleged losses.

The Trustee’s appellate brief concedes that E&Y’s failure to include a going concern statement in its 1995 audit report did not cause Taurus to go under and leave creditors with unpaid bills. The Trustee admits repeatedly that other factors—occurring well *after* the audit report—caused Taurus’s demise.

Most importantly, the Trustee concedes that “**the going concern situation in the fall, 1996 ... simply has no inherent connection with ... EY’s clean FY95 audit opinion.**” Pl. Br. 18 (emphasis added). But that is not all. The Trustee also admits that Taurus was hurt by adverse business factors that occurred well after E&Y’s audit report: “in mid-1996 ... decreasing sales and shrinking margins occurred.” *Id.* at 14; see also *id.* at 18 (the events of fall 1996 “happened after economic ups *and* downs”). To top it off, the Trustee forthrightly concedes that

⁸ Although *Movitz* and *Bastian* are securities fraud cases, “[t]he requirement of proving loss causation is a general requirement of tort law” and applies to breach of contract claims as well. *Movitz*, 148 F.3d at 763-64. Loss causation is simply “an exotic name” for “the standard rule of tort law that the plaintiff must allege and prove that, but for the defendant’s wrongdoing, the plaintiff would not have incurred the harm of which he complains.” *Bastian*, 892 F.2d at 685.

there was “an **intervening event**, specifically the new, more stringent loan terms.” *Id.* at 18 (emphasis added). Indeed, the Trustee acknowledges, Taurus’s “problems began **only after** the new lending arrangement” in May 1996; “new, more stringent bank loan terms shrunk its borrowing ability and created cash flow problems.” *Id.* at 14 (emphasis added). In short, according to the Trustee’s own brief, “[a] ‘**chasm**’ between EY’s FY95 audit opinion and the fall, 1996 exists.” *Id.* at 18 (emphasis added). After January 1996, the 1995 audit opinion “had by definition become **irrelevant**.” *Id.* (emphasis added).

The Trustee’s admissions make it crystal clear that E&Y’s 1995 audit report—which covered a period that ended on January 28, 1995—had absolutely no connection with the problems that Taurus encountered some 20 months later, in the fall of 1996. Rather, as the Trustee concedes, “[t]he reasons for Taurus’s economic problems”—which caused Corry to commit fraud and ultimately led to Taurus’s 1998 bankruptcy—were caused by “a combination of its new loan terms and traditional economic issues” that happened in 1996. Pl. Br. 26.

The Trustee’s concessions are completely consistent with the undisputed summary judgment evidence. To begin with, the Trustee’s expert did not opine that E&Y caused any of Taurus’s alleged losses. R.57-F, at 329. “I’m not offering any opinion with respect to causation.” *Id.* at 331. See also *id.* at 344-45 (“I’m not

offering any opinion that Ernst & Young caused anything ... with respect to the factors” that resulted in “a deepening financial crisis at Taurus”).

The testimony from Taurus’s senior management also does not point to E&Y as the culprit behind Taurus’s demise and consequent inability to pay its creditors. Wells and Corry were both asked why Taurus ultimately failed—they were the only witnesses who testified on the subject—and neither mentioned E&Y’s 1995 audit report. Instead, both identified a myriad of *other* reasons why Taurus went under, including economic pressures (*e.g.*, higher interest rates and reduced borrowing capacity on the Bank One loan after May 1996) and market forces (*e.g.*, lower sales, increased competition, and the loss of important customers). See p. 11, *supra*. The 1995 audit report is conspicuously absent from the long list of causal factors identified by Wells and Corry. See also AU §341.04 (Pl. App. 79) (“The auditor is not responsible for predicting future conditions or events”).

Taurus’s experience in attempting to sell the company in the summer of 1996 provides another indication of Taurus’s poor financial situation at the time. The prospective buyer quickly lost interest after reviewing Taurus’s financial data. R.57-C, at 240-42; R.57-A, at 197-202; R.57-B, at 3. Wells admitted that Taurus’s debt was too high and its margins too low. R.57-A, at 199.

One other critically important factor confirms that E&Y had nothing to do with Taurus's failure. Corry concluded in the fall of 1996 that the business and economic factors just listed made it impossible for Taurus to stay in business unless it defrauded the bank into continuing to provide Taurus with financing. R.57-C, at 150-52, 157, 181, 184, 213, 227-28; R.57-L, at 66-67. When the bank learned in the fall of 1997 that it had been deceived, it naturally refused to make any more loans. R.57-A, at 162. The Bank's actions led directly to Taurus's bankruptcy—and the Bank's conduct was indisputably triggered by Corry's fraud, not by E&Y's audit work.

Despite all of this, the Trustee contends that the factors that caused Taurus to file for bankruptcy in 1998 may be ignored because they occurred “after that critical time in the Fall of 1995” and those “subsequent events would not have happened later on if EY had not been negligent.” R.75, at 25. According to the Trustee, there would have been “no loan in May, 1996” on “more onerous terms,” “no subsequent cash flow problems,” “no business and market factors,” and “no fraud.” *Id.*

The Trustee's position has insurmountable flaws. On the factual side, the Trustee never offered *any* evidence that the many factors identified by Corry and Wells as the reasons for Taurus's failure would have been prevented by a going concern statement in the 1995 audit report. Wells, in fact, testified that a going

concern opinion in 1995 would not have caused Taurus to throw in the towel. R.57-A, at 179. Indeed, Taurus only entered bankruptcy involuntarily, when forced to do so by its creditors. R.57-K. The Trustee asserted vaguely in a brief that “something would have to have been done” (R.75, at 24), but “belief is not evidence.” *Pommier v. Peoples Bank*, 967 F.2d 1115, 1117 n.3 (7th Cir. 1992). Besides, after January 1996, the 1995 audit report was “moot” (R.57-F, at 422) and “irrelevant” (Pl. Br. 18) with respect to going concern issues.

The legal flaw is that the Trustee ignores the distinction between transaction causation and loss causation. The Trustee’s theory, if accepted and if supported by the evidence, might establish transaction (“but for”) causation. However, “but for” causation “is not a sufficient basis for imposing legal liability.” *Movitz*, 148 F.3d at 762. The Trustee must also prove loss causation. Saying that Taurus would have closed in 1995 had there been a going concern statement suggests “the cause of [Taurus’s] entering into the transaction in which [it] lost money but not the cause of the transaction’s turning out to be a losing one.” *Bastian*, 892 F.2d at 684. See also *Askanase v. Fatjo*, 130 F.3d 657, 676 (5th Cir. 1997) (a bankruptcy trustee cannot recover as a matter of law on the theory that but for the auditor’s alleged misstatements, LivingWell would have not continued to exist and would not have lost more money—that theory “would make Ernst & Young an insurer of LivingWell because Ernst & Young would be liable for LivingWell’s losses no

matter what created LivingWell's losses, *i.e.* a recession or a decline in the fitness industry").

The Trustee's concessions in his appellate brief and the uncontested evidence in the record demonstrate unequivocally that Taurus failed and could not pay its creditors because of (1) stringent new loan terms imposed by Bank One in May 1996; (2) Lisa Corry's fraudulent scheme to defraud Bank One, starting in the fall of 1996; and (3) a variety of business and market factors. There is not the slightest evidence that E&Y's failure to include a going concern qualification in the 1995 audit report caused Taurus's alleged losses, much less that there was an "unbroken chain of events" in a "natural and continuous sequence" directly from that audit report to alleged damage to Taurus years later. *Hill*, 644 N.E.2d at 896. Under these circumstances, there is no basis for any recovery by the Trustee. "The legal system is busy enough without shouldering the burden of providing insurance against business risks." *Movitz*, 148 F.3d at 763.

3. Taurus remained a going concern for nearly three years after January 28, 1995.

The Trustee's assertion that Taurus's alleged losses were caused by E&Y's failure to include a going concern qualification in the 1995 audit report is especially problematic for the Trustee because Taurus remained in business until 1998. The Trustee admits that a going concern statement in the 1995 report would only have covered from January 28, 1995 (the last date covered by the 1995

financial statements) until January 28, 1996. Pl. Br. 7. See also AU §341.02 (Pl. App. 78).

The Trustee conceded in the district court that a going concern issue is “‘moot’ once the one year period from the financial statement is over ... because the going concern does not extend out beyond the year, and the next year’s audit comes into play.” R.75, at 28; see also R.57-F, at 422 (Fitzgerald, the Trustee’s expert: a going concern issue is “moot” after the end of the one-year period); *id.* at 419 (when reading an audit report without a going concern qualification, Fitzgerald “would not be projecting out possibilities or something in the future that is two years away or three years away” because “the going concern evaluation is for a reasonable period of time not to exceed 12 months”). But given that the issue is “moot” once the one-year period is over and the company remains in business, how can the company be injured after that point by the auditor’s failure to express substantial doubt about the company’s ability to remain a going concern during the now-expired one-year period?

The Trustee does not say. And the Trustee has never cited any case holding that the failure to issue a going concern statement caused a company to go out of business almost three years after the balance sheet date. There is no such case as far as we know.

Taurus was still in business for almost two years after the 12-month period expired. That undisputed fact and Fitzgerald's testimony that a going concern issue is "moot" when the 12-month period ends, mean that the Trustee cannot bring a claim based on E&Y's purported negligence in not including a going concern statement in the 1995 audit report. See *In re Integrated Resources Sec. Litig.*, 815 F. Supp. 620, 670 (S.D.N.Y.) (dismissing claims against auditor based on failure to include going concern qualification where plaintiffs "have not alleged ... that [the entity] was not a going concern a year later"), *appeal dismissed*, 3 F.3d 49 (2d Cir. 1993). Indeed, when a company remains a going concern for more than a year after the balance sheet date, the auditor's "failure to include such a qualification cannot have constituted a material omission or misrepresentation." *Pew*, 2005 WL 3817472, at *9 (holding that the auditor's failure to include a going concern statement for the periods ending June 2000 and June 2001 was not a material misstatement because the company was a going concern until October 2002).

Put somewhat differently, a failure to warn does not cause damage if the risk that would have been warned of did not come to pass. See *Natural Gas Odorizing v. Downs*, 685 N.E.2d 155, 163 n.12 (Ind. Ct. App. 1997) (to establish proximate cause, the plaintiff's injury must be "a natural and probable consequence of the failure to warn"); *Barron v. Texas Dep't of Transp.*, 880 S.W.2d 300, 301, 304

(Tex. Ct. App. 1994) (because an accident was caused by plaintiff's collision with a stalled car, the defendant's failure to warn that a bridge was unsafe "was not a proximate cause of [plaintiff's] injuries").

B. There Is No Evidence That Taurus Relied On The Absence Of A Going Concern Qualification In The 1995 Audit Report.

To recover on any claim based on the audit of a company's financial statements, the plaintiff is required to prove reliance on the audit report. See *Johnson Bank*, 472 F.3d at 442 ("The audit report might flunk Accounting 101, but if the report didn't mislead anyone toward whom the auditor had a duty of care, the auditor would not have committed a tort"); *FDIC v. Ernst & Young*, 967 F.2d 166, 170 (5th Cir. 1992) ("If nobody relied upon the audit, then the audit could not have been a 'substantial factor in bringing about the injury'"); *Drabkin*, 905 F.2d at 455 (the trustee must prove, as part of the "chain of causation" for negligence and breach of contract claims, that "accurate audits would have prompted company action to cure or mitigate the company's basic economic problems").

Here, because the Trustee's claims are premised on the proposition that E&Y should have included a going concern qualification in its 1995 audit report, the Trustee cannot recover without evidence that Taurus relied on the absence of a going concern statement. There is no such evidence. The Trustee's expert, Fitzgerald, did not offer any opinion that Taurus relied on the absence of such a statement in the audit report. R.57-F, at 356 (Fitzgerald was "not opining that

Taurus, had there been a going concern statement in the fiscal year '95 audit report ... would have conducted a liquidation”), 410 (no opinion on “whether Taurus Foods relied on the absence of a going concern statement in the fiscal year '95 audit report”). Nor is there any such evidence from anyone else.

In particular, although the Trustee’s damages calculations are based on the assumption that Taurus would have liquidated itself had there been a going concern statement (R.57-F, at 308; R.57-O, ¶ 2), there is utterly no evidence that Taurus would have liquidated (or taken any other specific action) had E&Y included a going concern qualification in its 1995 audit report. Again, Fitzgerald did not offer any such opinion. He made clear that he was “not opining” that “had there been a going concern statement in the fiscal year '95 audit report ... that Taurus would have conducted a liquidation.” R.57-F, at 356. Rather, he limited his opinion to “if they had” liquidated the company, “here is what the result would have been.” *Id.*

And there is no other evidence that Taurus would have liquidated itself had there been a going concern statement. On the contrary, Donald Wells—50% co-owner of Taurus; its Executive Vice President, Secretary, and Treasurer; and its Rule 30(b)(6) witness (R.57-A, at 29, 37; R.57-D, H)—testified unequivocally that Taurus would *not* have shut down had there been a going concern statement in the 1995 audit report:

Q: Would you have pulled the plug on the business because Ernst & Young said we don't think you're going to be able to make it another year?

A: Would I have closed the doors?

Q: Yeah.

A: No. That's why I said I wouldn't have done that. I would have said we'll do everything we can. I want you to tell me this, because that's a wake up call. And we're going to do everything to prove you wrong.

R.57-A, at 179.⁹ Indeed, after Taurus discovered Lisa Corry's fraud in 1997, Wells still believed that he "could make a go of this company." *Id.* at 161. Taurus only entered bankruptcy when its creditors filed an involuntary petition. R.57-K. Even after the bankruptcy, Wells stated that "I know that we could have pulled that company out." R.57-A, at 161.

The absence of any evidence of reliance by Taurus is highlighted by what happened when it became painfully obvious in the fall of 1996 that the company could no longer pay its bills. Did Taurus begin the liquidation process, as it now claims it would have done had it been told there was a going concern issue in

⁹ Wells, without explanation, tried to reverse course in an affidavit filed 10 months after his deposition, in response to E&Y's summary judgment motion. R.68-G. But an affidavit that contradicts an earlier deposition is "so lacking in credibility" that it "cannot be credited" and is "entitled to zero weight in summary judgment proceedings." *Beckel v. Wal-Mart Assocs.*, 301 F.3d 621, 623 (7th Cir. 2002) (noting that the affidavit was "filed a suspiciously long seven months after the deposition").

1995? No—its senior financial officer decided to defraud the company’s lender. That also shows lack of reliance on the audit report. See *Drabkin*, 905 F.2d at 457 (defendant entitled to judgment as a matter of law where the company did nothing when it learned of the tax problem on which its claim was partly based); *Devaney*, 1989 WL 52375, at *6 (summary judgment for auditor on claims brought by bankruptcy trustee where there was no evidence that “a going concern qualification would have dissuaded Klausmann and Lindsay from purchasing AMI”).

Because there is not the slightest evidence that Taurus relied on the absence of a going concern qualification in the 1995 audit report, or would have liquidated itself if there had been a going concern statement in that report, E&Y is entitled to judgment. See *Drabkin*, 905 F.2d at 456-57 (no causation where there was no evidence that the company would have filed for bankruptcy sooner if the auditor had conducted an accurate audit and alerted the company about its grave financial situation).¹⁰

¹⁰ Because the Trustee may assert only claims belonging to Taurus, it is irrelevant whether any third parties relied on the absence of a going concern statement in the 1995 audit report. *Holland v. Arthur Andersen & Co.*, 571 N.E.2d 777, 782 (Ill. App. Ct. 1991), *appeal dismissed*, 591 N.E.2d 22 (Ill. 1992); *KPMG Peat Marwick v. Asher*, 689 N.E.2d 1283, 1289 (Ind. Ct. App. 1997) (Missouri law). In any event, there is no such evidence. The Trustee refers to Bank One’s new loan terms in May 1996 (Pl. Br. 2, 10-11), but that occurred some 15 months after the end of Taurus’s 1995 fiscal year. The Trustee cites no evidence indicating that the bank would have stopped lending altogether if there had been a going concern statement in the 1995 audit report. The bank was well acquainted with Taurus’s financial troubles; that is why it imposed more onerous terms and

C. Taurus Has Not Suffered Any Damages.

1. The Trustee offered no evidence of diminution in Taurus's value.

Under Indiana law, “[w]hen an established business is injured, interrupted, or destroyed, the measure of damages is the diminution in value of the business, with interest, by reason of the wrongful act. The diminution may be measured by loss of profit.” *Serletic v. Noel*, 700 N.E.2d 1159, 1162 (Ind. Ct. App. 1998) (quoting *Knauf Fiber Glass v. Stein*, 615 N.E.2d 115, 128 (Ind. Ct. App.), *aff'd in relevant part*, 622 N.E.2d 163, 166 (Ind. 1993)). The Trustee’s only damages evidence came from his expert, Fitzgerald. However, Fitzgerald admittedly *never* compared Taurus’s value on different dates—“I was not engaged to nor did I prepare a formal valuation of Taurus” (R.57-O, at 5)—and he offered no opinion that Taurus lost profits by not remaining in business. Consequently, the Trustee has no evidence of damages. The defendant is entitled to judgment when the plaintiff’s damages theory does not comport with the law of damages. *Movitz*, 148 F.3d at 765.

2. The Trustee cannot recover for damages suffered by creditors.

Rather than offer evidence of diminished value, the Trustee seeks to recover nearly \$3 million lost not by Taurus, but by some of its creditors. This constitutes

transferred Taurus’s loan to its asset-based lending group in Milwaukee. See pp. 7-8, 10, *supra*.

almost all of the Trustee's alleged damages.

Fitzgerald's damages opinion assumes that Taurus would have liquidated itself had the 1995 audit report contained a going concern statement and that Taurus, therefore, "could have avoided ... creditor claims"—debt "owed by Taurus to various creditors." R.57-F, at 308, 314, 400. Fitzgerald measured damages by adding up some (but not all) of the creditors' claims asserted in Taurus's bankruptcy; the total is \$2.973 million. *Id.* at 303, 387, 392-94; R.57-O, at 4-5. Taurus has not paid these claims. R.57-F, at 405, 407.

Fitzgerald conceded that Taurus "isn't out that \$3 million, because it hasn't paid that \$3 million." *Id.* at 407. Similarly, Fitzgerald acknowledged that Taurus was not damaged by receiving "things of value" for which it "had not yet paid"; any damage was suffered by "the people to whom the money is owed." *Id.* at 405-06. Fitzgerald testified that under general bankruptcy principles, "Taurus won't have to pay those unpaid debts" at the end of the bankruptcy, and that a company "benefit[s]" when an unpaid liability is "forgiven" and "taken off the books." *Id.* at 408-09, 444.

Fitzgerald's testimony confirms that, as a corporate debtor in a Chapter 7 liquidation, Taurus did not suffer any harm from incurring debts that it will never pay. Any money that the Trustee recovers in this litigation will go to creditors whose claims the Trustee is attempting to assert. And if (as will almost certainly

be the case) the creditors are not paid 100 cents on the dollar, they will not be able to sue Taurus for the shortfall; Taurus will not exist post-bankruptcy, and all its funds will be distributed to creditors. In other words, Taurus itself will not be affected one way or another by the outcome of this case. Significantly, Fitzgerald did not opine that Taurus would be better off if the creditors' claims are paid. R.57-F, at 409-10.

The Trustee's prospects for recovering creditors' losses rests on the hope that this Court will ignore Fitzgerald's testimony, ignore Indiana precedent (*Knauf and Serletic*), and instead adopt a "deepening insolvency" theory of damages. R.75, at 30-31 (Trustee's summary judgment response). Deepening insolvency posits that a corporation was somehow harmed because the defendant's conduct supposedly prevented the company from filing for bankruptcy or liquidating earlier than it ultimately did, by which time it had become even more insolvent. See generally *In re CitX Corp.*, 448 F.3d 672, 677-78 (3d Cir. 2006); Sabin Willett, *The Shallows of Deepening Insolvency*, 60 BUS. LAW. 549 (2005).

The phrase "deepening insolvency" has its genesis in *Schacht v. Brown*, 711 F.2d 1343 (7th Cir. 1983), a RICO case brought by the Illinois liquidator of a failed insurer against company insiders and others. The liquidator alleged that the defendants kept the company in business after it was insolvent and looted valuable assets, thereby deepening the insurer's insolvency. The defendants argued that the

liquidator lacked standing under Illinois law because an insolvent corporation was not damaged by “artificial prolongation” of its life, but this Court “decline[ed] to speculate that the Illinois courts would accept this restriction.” *Id.* at 1350. It stated that the “the corporate body is ineluctably damaged by the deepening of its insolvency” in two respects: the corporation itself suffers “increased exposure to creditor liability,” and its shareholders are deprived of the chance “to cut their losses.” *Id.*

Since then, courts and commentators have recognized that a broad deepening insolvency theory does not make sense as an economic matter. An insolvent corporation is not harmed by incurring additional debt. *CitX*, 448 F.3d at 677-78 (rejecting the argument that deepening insolvency was “a valid theory of damages” in Pennsylvania); *In re Radnor Holdings Corp.*, 353 B.R. 820, 849 (Bankr. D. Del. 2006) (deepening insolvency is “an impermissible measure of damages”) (Delaware law). And shareholders have no need to cut their losses. “You cannot cut what already you have lost, and at the point of insolvency the shareholders have already lost everything.” Willett, 60 BUS. LAW. at 561. Accord *Askanase v. Fatjo*, 1996 WL 33373364, at *28 (S.D. Tex. Apr. 1, 1996).

There are serious problems with extending *Schacht* to the Trustee’s damages theory.

First, *Schacht* did not adopt an expansive deepening insolvency theory. The

case concerned fraudulent corporate looting, and the Court limited the theory to that context. 711 F.2d at 1348, 1350 (deepening insolvency is “the fraudulent prolongation of a corporation’s life beyond insolvency”; the defendants allegedly “systematically looted” the business). See also *CitX*, 448 F.3d at 681 (“only fraudulent conduct will suffice” for deepening insolvency as a cause of action in Pennsylvania, but never a damages theory). A deepening insolvency theory may be warranted in looting cases because a bankruptcy trustee or a liquidator may recover fraudulent transfers of the debtor’s funds directly from the recipients of those transfers. 11 U.S.C. §548. That is not a reason to permit a trustee to recover creditors’ losses in a negligence case against the company’s outside auditor, particularly when a trustee or liquidator does not have the power to assert creditors’ personal claims. See *Holland*, 571 N.E.2d at 782. Accordingly, *Schacht* cannot be extended to the non-looting context. Because this case is not a looting or fraud case, the deepening insolvency theory can have no application. See *CitX*, 448 F.3d at 681.

Second, *Schacht* involved a motion to dismiss. This case, in contrast, was decided on summary judgment, and the Trustee’s own expert admitted that unpaid creditors’ claims did not damage Taurus. Undisputed facts cannot be ignored to adopt the Trustee’s theory.

Third, *Schacht* did not construe Indiana law. Indiana has never adopted the

deepening insolvency theory nor hinted that it might. *Knauf* was brought by a bankruptcy trustee who alleged that the defendant had caused the bankruptcy, but the Indiana Court of Appeals held that “the measure of damages is the diminution in value of the business.” 615 N.E.2d at 128. The Indiana Supreme Court summarily affirmed on this issue. 622 N.E.2d at 166.

Fourth, Schacht does not say how to measure deepening insolvency, but totting up creditors’ losses, as the Trustee proposes, is plainly not the right measure even under Illinois law, which *Schacht* was construing. The Illinois Appellate Court made this clear eight years after *Schacht* in *Holland v. Arthur Andersen & Co.*, 571 N.E.2d 777 (Ill. App. Ct. 1991). The bankruptcy trustee for American Reserve Corporation (“ARC”) sued an accounting firm that had audited ARC’s financial statements. The court held that even assuming *Schacht*’s deepening insolvency theory is viable, it had to reject the argument that the auditor “‘caused harm to ARC’” when creditors “‘extended credit’” to ARC after ARC became insolvent. 571 N.E.2d at 782 (affirming summary judgment for the auditor). The “proofs of claims” filed *by the creditors* in ARC’s bankruptcy—the only evidence of damages—did not support “a theory of damages *as to ARC*”; they simply showed “the injuries suffered by ARC’s creditors.” *Id.* (emphasis added).

It makes sense that when an insolvent company does not repay its debts, the harm is suffered by the particular creditors whose debts remain unpaid, not by the

insolvent company. An insolvent company is “the beneficiary” when it receives goods or services from creditors that are not repaid—it “receiv[es] goods and services, the obligation to pay for which [i]s discharged in bankruptcy.” *Colotone Liquidating Trust v. Bankers Trust*, 243 B.R. 620, 622 (S.D.N.Y. 2000). See also *Christians v. Grant Thornton, LLP*, No. CT 04-006593, at 10 (Hennepin County Minn. May 12, 2006) (copy attached at R.99) (following *Holland* and rejecting claim for \$14 million in deepening insolvency damages—“this \$14 million is the amount Technimar owes its creditors. The creditors suffered the injury, not Technimar”). And “[w]hen a third party has injured not the bankrupt corporation itself but a creditor of that corporation, the trustee in bankruptcy cannot bring suit against the third party. He has no interest in the suit.” *Steinberg v. Buczynski*, 40 F.3d 890, 893 (7th Cir. 1994).

It is clear from Fitzgerald’s testimony and the authorities discussed above that Taurus was not harmed by incurring debts it will never repay. Because Indiana has never recognized deepening insolvency as a measure of damages, and because the alleged losses were suffered by particular creditors, the Trustee cannot recover the nearly \$3 million in unpaid creditors’ claims.

3. The other alleged damages item—bankruptcy expenses and costs—is not recoverable.

The Trustee’s damages calculation has one other component: \$185,000 in expenses and costs incurred during Taurus’s bankruptcy. R.57-O, at 5. Not only is

this item not recoverable under *Serletic*, 700 N.E.2d at 1162, but Fitzgerald could not identify any part of those expenses that would “differ[] from the types of costs and fees that would be associated with conducting an asset liquidation.” R.57-F, at 390. And Fitzgerald conceded that Taurus would have incurred liquidation costs of \$250,000 anyway under the liquidation analysis he used to calculate damages. *Id.* at 368-71. Since that is more than the \$185,000 in expenses that Taurus actually incurred in the bankruptcy, Taurus *saved* money on this item by filing for bankruptcy instead of liquidating in 1995-1996. Because the bankruptcy thus did not cause Taurus to incur any additional expenses it would not have borne anyway under Fitzgerald’s liquidation analysis, the Trustee cannot recover the \$185,000. A plaintiff “is not entitled to be placed in a better position than he would have been had the breach not occurred.” *Pierce v. Drees*, 607 N.E.2d 726, 729 n.2 (Ind. Ct. App. 1993); see also *Remington Freight Lines v. Larkey*, 644 N.E.2d 931, 941 (Ind. Ct. App. 1994) (tort damages are designed “to place the plaintiff in the same financial position in which he would have been had the tort not occurred”).

III. The Trustee Waived His Argument On Costs, And In Any Event, The District Court Did Not Abuse Its Discretion In Awarding Costs.

The Trustee’s only argument for reversing the award of \$28,000 in costs (R.117) is that Taurus’s bankruptcy estate is supposedly indigent. Pl. Br. 29-30. This contention is groundless.

For starters, the Trustee never made an indigency argument until appeal. In

the district court, the Trustee argued only that costs should not be imposed because he litigated in good faith and the law was unsettled (arguments abandoned on appeal). R.112, at 5; R.110, at 8-10. Because indigency was not raised below, it cannot be asserted on appeal. “It is axiomatic that issues and arguments which were not raised before the district court cannot be raised for the first time on appeal.” *Republic Tobacco v. North Atlantic Trading*, 381 F.3d 717, 728 (7th Cir. 2004). See *Badillo v. Central Steel & Wire*, 717 F.2d 1160, 1165 n.1 (7th Cir. 1983) (argument regarding plaintiff’s financial condition and its effect on his request for costs was waived because not raised below); *Park v. City of Chicago*, 297 F.3d 606, 617 n.8 (7th Cir. 2002) (plaintiff waived argument that she was unable to pay costs by not raising it until reply brief on appeal).

Even if the argument had not been waived, “there is a heavy presumption in favor of awarding costs to the prevailing party.” *Majeske v. City of Chicago*, 218 F.3d 816, 824 (7th Cir. 2000) (affirming award of \$38,000 in costs); see Fed. R. Civ. P. 54(d) (“costs other than attorneys’ fees shall be allowed as of course to the prevailing party”). A decision awarding costs will be overturned only if the district court abuses its discretion, *i.e.*, “when no reasonable person could take the view adopted by the trial court.” *Rivera v. City of Chicago*, 469 F.3d 631, 636 (7th Cir. 2006).

The discretion to deny costs based on indigency is “narrow.” *Id.* The

Trustee suggests that indigency always excuses one from paying costs (Pl. Br. 29-30), but that is incorrect. “[I]ndigence does not automatically excuse the losing party from paying the prevailing party’s costs.” *Rivera*, 469 F.3d at 635. “Someone has to bear the costs of litigation, and the winner has much the better claim to be spared them. ... Straitened circumstances do not justify filing weak suits and then demanding that someone else pay the bill.” *Luckey v. Baxter Healthcare*, 183 F.3d 730, 734 (7th Cir. 1999) (affirming award of \$20,000 in costs against plaintiff who claimed inability to pay). See also *McGill v. Faulkner*, 18 F.3d 456, 458-60 (7th Cir. 1994) (affirming cost award against prisoner proceeding *in forma pauperis*).

Moreover, a party claiming indigence bears the burden “to provide *evidence* of [the] inability to pay.” *Corder v. Lucent Technologies*, 162 F.3d 924, 929 (7th Cir. 1998) (emphasis added). The Trustee has the temerity to blame the district court for “not permitting full development of the Plaintiff’s indigence.” Pl. Br. 30 n.102. That is false. The Trustee submitted a full argument in the district court on why costs should not be awarded and elected not to mention indigency, let alone offer evidence of indigency. R.110, at 8-10. This Court rejects “unsupported allegations of indigence” when, as here, the losing party “offered no such evidence” below. *Corder*, 162 F.3d at 929. Accord *Rivera*, 469 F.3d at 636-37; *McGill*, 18 F.3d at 459 (affirming cost award where prisoner “failed to present any

evidence to the trial court of his indigency”).¹¹

For all these reasons, it would not have been an abuse of discretion for the district court to reject an indigency argument if the Trustee had made one, which he did not. *Luckey*, 183 F.3d at 734; *Corder*, 162 F.3d at 929; *McGill*, 18 F.3d at 458-60.

CONCLUSION

The judgment should be affirmed.

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Respectfully submitted,

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¹¹ The Trustee contends on appeal that Taurus’s estate is “insolvent by \$3.2 million” (Pl. Br. 30), but that is not an out-of-pocket amount—it includes almost \$3 million of claims by Taurus’s *creditors* who have not been paid. R.56, at 29-33; R.57-O, at 4.

CERTIFICATE OF COMPLIANCE WITH FED. R. APP. P. 32(a)

This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B). According to the word processing program used to prepare this brief (Word 2002 SP3), this brief contains 13,989 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

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CIR. R. 31(e)(1) CERTIFICATE

I hereby certify that I have filed this brief with the Court electronically on a virus-free disk in non-scanned PDF format.

James C. Schroeder

CERTIFICATE OF SERVICE

I hereby certify that on February 1, 2007, I caused two copies of the Brief of Defendant-Appellee Ernst & Young LLP to be served by U.S. Mail on the following counsel for plaintiff:

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