SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: BARBARA R. KAPNICK, Justice

PART 39

Index Number : 650841/2011
GSP FINANCE LLC
vs.
KPMG LLP
SEQUENCE NUMBER : 001
DISMISS ACTION

INDEX NO. 650841/11

MOTION DATE

MOTION SEQ. NO. 001

MOTION CAL. NO.

this motion to/for

	PAPERS NUMBERED
Notice of Motion/Order to Show Cause — Affidavits — Exhibits ...	
Answering Affidavits — Exhibits	
Replying Affidavits	

Cross-Motion: ☐ Yes ☒ No

Upon the foregoing papers, it is ordered that this motion

MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

Dated: 9/6/12

BARBARA R. KAPNICK, J.S.C.

Check one: ☐ FINAL DISPOSITION ☒ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

☐ SUBMIT ORDER/ JUDG. ☐ SETTLE ORDER/ JUDG.

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 39

----------X

GSP FINANCE LLC,

Plaintiff,

-against-

KPMG LLP,

Defendant.

----------X

DECISION/ORDER
Index No. 650841/11
Motion Seq. No. 001

BARBARA R. KAPNICK, J.:

In this action for fraud, aiding and abetting fraud, civil conspiracy, and negligent misrepresentation, defendant KPMG LLP ("KPMG") moves, pursuant to CPLR 3211 (a) (7), for an order dismissing the Complaint.

Background

Plaintiff GSP Finance LLC ("GSP") is the lending arm of Galatioto Sports Partners, a well known provider of financial services to the professional sports industry. This case involves two professional sports teams, Major League Baseball's Texas Rangers and the National Hockey League's Dallas Stars, both of which were owned by an investment vehicle known as Hicks Sports, which is a holding company controlled by private equity investor Thomas Hicks.

Hicks enjoyed early success after acquiring the Dallas Stars in 1996 and the Texas Rangers in 1998. The Stars won the Stanley Cup in 1999 and finished as runners-up in 2000. However, when the economy slowed in the early 2000s, and both teams slipped in the standings, Hicks Sports began to struggle financially, losing $113 million in 2002, $68 million in 2003, and $95 million in 2004. Complaint, ¶ 13. Hicks Sports was still losing money in 2005, when just before the end of that year, it secured capital by entering into a $325 million syndicated credit facility. Complaint, ¶ 14. Six months later, Hicks Sports was in need of additional capital, and the lenders made an additional $75 million available. Six months after that, in December 2006, Hicks Sports needed yet more capital. Complaint, ¶¶ 15-16.

Hicks Sports then entered into two credit agreements for a total of another $140 million, taking the available level of debt to $540 million. Complaint, ¶¶ 16-17. The lenders represented that they had made their own independent investigation of the financial condition of Hicks Sports, and would make their own appraisals of Hicks Sports' creditworthiness on an ongoing basis. Credit and Guaranty Agreements, 9.5 (a). GSP extended loans to Hicks Sports under the First and Second Lien Credit Agreements in the total sum of $67 million. Complaint, ¶ 17.

KPMG is an accounting firm that undertook an audit of Hicks Sports' consolidated Fiscal Year 2007 financial statements. Complaint, ¶ 26. The audit report was completed in March 2008, approximately one year and three months after the parties entered into the latest Credit Agreements. The audit indicated that Hicks Sports' liabilities for 2007 totaled almost $824 million, and that its accumulated deficit was approximately $480 million. According to defendant, based in part on Thomas Hicks' alleged willingness and ability to support the company financially, as reflected in a subscription commitment that was executed by Thomas Hicks on March 15, 2008 (the "Subscription Commitment"), the audit report did not include a "going concern" reference, which meant that KPMG believed that the company had the ability to continue as a going concern for a year past December 31, 2007.

During 2008, Thomas Hicks infused nearly $50 million in cash into the company. The company suffered losses of $58 million for the year, and borrowed an additional $15 million under its Credit Agreements. Hicks Sports paid its interest payments on the loans during 2008. Complaint, ¶¶ 49-51. However, with the onset of the financial crisis in 2008, additional loans were not forthcoming, and on March 31, 2009, Hicks Sports failed to make a scheduled interest payment. Complaint, ¶ 51. The Texas Rangers filed for bankruptcy protection in May of 2010 and eventually Hicks Sports

sold the team. Complaint, ¶ 53. Hicks Sports also sought a buyer for the Dallas Stars; however, as of the time this motion was argued, no such sale had been completed. Nor had Hicks Sports, as of that time, filed for bankruptcy.

Although GSP lent money to Hicks Sports prior to the time that KPMG performed its audit, it contends that, had KPMG conducted its audit properly, GSP would have been able to declare Hicks Sports to be in default earlier, and would not have suffered the extent of damages which it later suffered due to Hicks Sports' default in paying its obligations under the loan. Specifically, GSP maintains that KPMG should have included a "going concern" reference in the financial statement. In addition, GSP contends that KPMG misrepresented Hicks Sports' financial position by delivering a Compliance Letter in March 2008 that made no mention of Hicks Sports' breach of its Debt Covenant and a separate covenant requiring Hicks Sports to maintain minimum liquidity reserves. GSP maintains that the total debt level should have included money owed on capital leases, as it had in previous years. Complaint, ¶ 42. KPMG asserts that the controlling definition of "Consolidated Total Debt" specifically provides that debt is defined only as "indebtedness for borrowed money" and, therefore, money owed on capital leases, which is not a debt arising from borrowed money, was appropriately left out.

On this motion, KPMG seeks to dismiss the Complaint on the grounds that: (1) as to the fraud claim, the Complaint does not provide the necessary detailed allegations, as required by CPLR 3016 (b); (2) as to the negligent misrepresentation claim, GSP fails to allege facts showing a relationship sufficiently near privity with KPMG to allow an assertion of a negligence claim; (3) GSP fails to plead the necessary prerequisites for an aiding and abetting fraud claim; and (4) New York does not recognize an independent tort for civil conspiracy.

Discussion

Fraud

KPMG contends that GSP failed to adequately plead scienter, and that, therefore, the fraud claim fails.

GSP's fraud claim has two predicates. The first is directed against KPMG's audit report on Hicks Sports' 2007 financial statements and alleges that KPMG's audit report improperly omitted a "going concern" reference. The second issue involves a separate Debt Compliance Letter in which KPMG reported on Hicks Sports' compliance with a contractual debt covenant.

In order to plead a cause of action for fraud, "a plaintiff must allege misrepresentation of material fact, falsity, scienter,

deception and injury." *LaSalle Natl. Bank v Ernst & Young*, 285 AD2d 101, 109 (1st Dept 2001). General allegations of scienter are not sufficient; in a fraud claim against an accountant, the pleading must contain "a particularized factual assertion which supports the inference of scienter." *Houbigant, Inc. v Deloitte & Touche, LLP, 303 AD2d 92, 97 (1st Dep't 2003); see also Credit Alliance Corp. v Anderson & Co.*, 65 NY2d 536 (1985); *Giant Group v Arthur Andersen LLP*, 2 AD3d 189, 190 (1st Dept 2003).

GSP argues that the requirements of CPLR 3016 (b) are met when "the complaint contains some rational basis for inferring that the alleged misrepresentation was knowingly made." *Houbigant, Inc. v Deloitte & Touche*, 303 AD2d at 98. GSP contends that KPMG knowingly or recklessly misrepresented Hicks Sports' ability to continue as a going concern, and that GSP has advanced several allegations that KPMG was on notice at the time of its March 2008 audit report that Hicks Sports' deteriorated financial condition had created substantial doubts as to its ability to continue as a going concern. First, Hicks Sports' budget for fiscal year 2008 allegedly raised doubts as to its ability to generate sufficient cash flow to meet its debt service obligations, and, in fact, forecast a cash flow shortfall of $60 million. In view of Hicks Sports having no additional borrowing capacity, that shortfall would cause a gap which would be difficult to bridge. Second, GSP

points to the report by the federal regulators at the Shared National Credit Program ("SNC") as further evidence of KPMG's inaccurate conclusions. The SNC's May 2007 audit resulted in a downgraded rating on the Credit Agreements, (Complaint, ¶¶ 45-46), and determined that the Credit Agreements were inadequately protected and that there was a distinct possibility that the lenders would sustain a loss if the deficiencies were not corrected.

KPMG apparently relied on the Subscription Commitment, in which Thomas Hicks agreed to provide money to Hicks Sports. GSP argues that such reliance was inappropriate because the parties to the Subscription Commitment could modify it at any time. In other words, Thomas Hicks, who was a party to both sides of the agreement, in his personal capacity on one side and in his capacity as owner of Hicks Sports on the other side, could revoke it at any time, at his whim. According to GSP, allowing such an illusory agreement to mitigate doubts regarding Hicks Sports' ability to continue as a going concern demonstrates KPMG's scienter, because it constitutes either deliberate fraud or a "refusal to see the obvious, a failure to investigate the doubtful." *Curiale v Peat, Marwick Mitchell & Co.*, 214 AD2d 16, 28 (1st Dept 1995).

GSP also argues that KPMG's acceptance of the Subscription Commitment grossly violated the standards of care an auditor should observe. GSP contends that KPMG conspired with Hicks Sports to fraudulently misrepresent the extent to which the Subscription Commitment dispelled doubts as to Hicks Sports' ability to continue as a going concern in order not to jeopardize its future prospective revenue for providing services to Hicks Sports and other entities controlled by Thomas Hicks. GSP asserts that merely because Thomas Hicks did, in fact, provide the funding is irrelevant, because that funding was provided in order to enable Thomas Hicks to time Hicks Sports' default in the most strategically advantageous manner for Thomas Hicks.

GSP also contends that KPMG fraudulently misrepresented Hicks Sports' compliance with Debt and Liquidity Covenants in the Credit Agreements by reclassifying certain liabilities so that they would not be counted toward the consolidated total debt. Had they been included as in prior years, GSP argues, Hicks Sports would have exceeded its debt limit, thereby allowing GSP to pursue its remedies for breach of the Credit Agreements at an earlier point.

The Complaint alleges that Hicks Sports' revised 2008 budget, released in first quarter 2008, already projected that its liquid reserves would fall below $15 million in fourth quarter 2008, which

would result in a breach of the First Lien Liquidity Covenant. Complaint, ¶ 25. Nonetheless, rather than acknowledging any breach, GSP allowed Hicks Sports to exclude capital leases from its consolidated total debt, although they had previously been included in the consolidated total debt calculation, thereby allegedly exacerbating the breach by allowing Hicks Sports to assume additional indebtedness. Complaint, ¶ 23. KPMG's audit and compliance certification were to "be applied on a basis consistent with prior years (except as otherwise disclosed in such financial statements. . .)". According to GSP, without making any mention that Hicks Sports had altered the methodology it had used and KPMG had certified in prior years, KPMG misrepresented that Hicks Sports remained in compliance.

KPMG urges the Court to review its 2007 financial statements for Hicks Sports which includes the amount owed on capital leases in a column right below the total indebtedness. However, as GSP points out, this does not resolve how KPMG arrived at its conclusion that Hicks Sports remained in compliance with the Debt Covenant in a manner consistent with prior years. GSP alleges that Hicks Sports was in fact in breach of the First Lien Debt Covenant when KPMG issued its Fiscal Year 2007 Debt Compliance Letter, and by misrepresenting that Hicks Sports remained in compliance, KPMG

prevented GSP and the other lenders from declaring Hicks Sports in default and exercising their remedies under the Credit Agreements.

Since, on a motion to dismiss pursuant to CPLR 3211, the pleading is to be afforded a liberal construction and the Court is to give the plaintiff the benefit of every favorable inference, determining only whether the facts as alleged fit within any cognizable legal theory (*Leon v Martinez*, 84 NY2d 83, 87-88 [1997]), this Court will deny defendant's motion to dismiss the fraud claim to the extent it is based on the Debt Compliance Letter.

With respect to the going concern reference, KPMG was permitted to take into account Thomas Hicks' agreement to provide funding to Hicks Sports. KPMG may have concluded, rightly, that it would be in Thomas Hicks' best interest to invest his own money during 2008 in order to prevent losing more of his investment by allowing Hicks Sports to default on its obligations. In fact, not only did Thomas Hicks infuse nearly $50 million into the company, but Hicks Sports did continue to meet its obligations to the lenders until after December 2008. Viability as a going concern is intended to deal only with a year following the date of audit. Thus, KPMG accurately forecast that Hicks Sports would continue as a going concern for the relevant time period.

Nonetheless, there is a question as to whether KPMG should have relied on Thomas Hicks' Subscription Commitment without including any cautionary information in its report, since if Thomas Hicks had opted not to invest the money, Hicks Sports did not have a backup plan for avoiding default. Under such circumstances, there is a question of fact as to whether KPMG's failure to include a qualified opinion as to a going concern certification constituted fraud on the part of KPMG, causing damage to the plaintiff.

Consequently, the Court concludes that this portion of the fraud claim should also be continued.

Negligent Misrepresentation

KPMG argues that the fourth cause of action for negligent misrepresentation must be dismissed because the Complaint fails to plead the factual predicate of a "contractual relationship or its equivalent" as mandated by the Court of Appeals in *Credit Alliance Corp. v Anderson & Co.*, 65 NY2d at 550. Since there was admittedly no contract between these parties, the Complaint had to allege that plaintiff was a "known party" to KPMG at the relevant time and that there was "linking conduct" between GSP and KPMG in connection with the audit. *See Sykes v RFD Third Ave. 1 Assoc., LLC*, 15 NY3d 370, 373-374 (2010); *Westpac Banking Corp. v Deschamps*, 66 NY2d 16 (1985); *Credit Alliance Corp., supra*. For the reasons stated on

the record during the oral argument held on September 22, 2011, this cause of action is dismissed.

Aiding and Abetting Fraud

"In order to plead properly a claim for aiding and abetting fraud, the complaint must allege: '(1) the existence of an underlying fraud; (2) knowledge of this fraud on the part of the aider and abettor; and (3) substantial assistance by the aider and abettor in achievement of the fraud' (citations omitted)." *Stanfield Offshore Leveraged Assets, Ltd. v Metropolitan Life Ins. Co.*, 64 AD3d 472, 476 (1st Dep't 2009), *lv den.* 13 NY3d 702 (2009).

GSP contends that it has adequately pled facts to support its claim that KPMG aided and abetted Hicks Sports in perpetrating a fraud on GSP.

First, the Complaint alleges fraud on the part of Hicks Sports in that it assumed more debt than it was permitted under the First Lien Debt Covenant and excluded capital leases (and other obligations) from its consolidated total debt. (Complaint, ¶¶ 22-23). GSP also alleges that Hicks Sports' budget for the coming years projected a cash flow shortfall and fraudulently misrepresented its position as a going concern. Complaint, ¶¶ 24, 40. In fact, GSP alleges throughout its Complaint that KPMG had knowledge of Hicks Sports' misrepresentations and fraud.

As the Appellate Division, First Department has stated:

> actual knowledge need only be pleaded generally, cognizant, particularly at the prediscovery stage, that a plaintiff lacks access to the very discovery materials which would illuminate a defendant's state of mind. Participants in a fraud do not affirmatively declare to the world that they are engaged in the perpetration of a fraud. The Court of Appeal's has stated that an intent to commit fraud is to be divined from surrounding circumstances (*see Eurycleia Partners, LP v Seward & Kissel, LLP*, 12 NY3d 553 [2009]).

Oster v Kirschner, 77 AD3d 51, 55-56 (1st Dep't 2010); see also Houbigant, Inc. v Deloitte & Touche LLP, 303 AD2d at 96-98.

Further, GSP has alleged in the Complaint that KPMG assisted Hicks Sports in perpetrating its fraud by issuing a clean audit report and Compliance Letter omitting any going concern reference on the financial report or reference to the reclassification of the capital leases in the Compliance Letter, when it knew Hicks Sports had financial problems and the only way out was the Subscription Commitment which was never a guaranteed commitment. "Under New York law, substantial assistance occurs 'when a defendant affirmatively assists, or helps conceal, or fails to act when required to do so, thereby enabling the fraud. . .to occur.' The aider/abettor's actions must also 'proximately cause [] the harm on which the primary liability is predicated.'" *Nathel v Siegal*, 592 FSupp2d 452, 470 (SDNY 2008) (internal citations omitted). In the Complaint, GSP specifically alleges that "KPMG substantially assisted Hicks Sports' fraud by certifying that its consolidated financial statements 'present fairly, in all material respects, the financial position of [Hicks Sports] and subsidiaries. . . and the

results of their operations and their cash flows. . .in conforming with U.S. generally accepted accounting principles.'" Complaint, ¶ 72. Further, GSP alleges that KPMG proximately caused it harm.

> Had KPMG truthfully represented Hicks Sports' position in March 2008, the lenders would have been able to declare Hicks Sports in breach of both the going concern requirement and the First Lien Debt Covenant, exercise their rights under the Credit Agreements nearly one year earlier, and obtain full repayment on the loans.

Complaint, ¶ 54.

Since GSP has sufficiently alleged the elements for aiding and abetting fraud, the Court declines to dismiss the second cause of action.

Civil Conspiracy

Finally, New York does not recognize an independent tort of civil conspiracy. *Alexander & Alexander of N.Y. v Fritzen*, 68 NY2d 968, 969 (1986). However, since the fraud and aiding and abetting fraud claims have survived this motion to dismiss, the plaintiff may plead the existence of a conspiracy to connect the actions of the defendant with an underlying tort and establish that those actions were part of a common scheme. See *Levin v Kitsis*, 82 AD3d 1051, 1052 (2d Dept 2011).

Conclusion

Accordingly, defendant's motion is granted only to the extent that the fourth cause of action for negligent misrepresentation is dismissed, and is otherwise denied.

Defendant is directed to serve an Answer to the remaining causes of action in the Complaint within 20 days after service of a copy of this order with notice of entry.

Counsel are directed to appear for a preliminary conference in IA Part 39, 60 Centre Street, Room 208, on October 31, 2012, at 10:00 a.m.

This constitutes the decision and order of this Court.

Dated: September 6, 2012

BARBARA R. KAPNICK
J.S.C.

BARBARA R. KAPNICK
J.S.C.