To Be Argued By:
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New York Supreme Court

APPELLATE DIVISION—FIRST DEPARTMENT

ZOHAR CDO 2003-1 LIMITED and ZOHAR II 2005-1 LIMITED,

Plaintiffs-Appellants,

—against—

XINHUA SPORTS & ENTERTAINMENT LIMITED and ANDREW CHANG,

Defendants,

LORETTA FREDY BUSH,

Defendant-Respondent.

BRIEF FOR PLAINTIFFS-APPELLANTS ZOHAR CDO 2003-1 LIMITED AND ZOHAR II 2005-1 LIMITED [FILED UNDER SEAL]

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INTRODUCTION

This appeal concerns the fraudulent inducement of loans of $57.8 million to a Chinese media conglomerate, Xinhua Sports & Entertainment Ltd. ("XSEL"). Fredy Bush was the CEO of XSEL, and she obtained these loans from two investment funds, based on a series of lies. Bush, who subsequently pleaded guilty to a federal felony, blatantly misrepresented XSEL's financial condition, its prospects and the very nature of its business operations in order to induce the loans.

Bush gave the funds, who are the Plaintiffs in this action, forecasts that were astronomically higher than XSEL's undisclosed "internal numbers." For example, Bush presented Plaintiffs with a supposed "worst case" scenario showing that XSEL had ample cash to repay the loan, but concealed an internal worst case scenario predicting a "$30-40 m[illion] funding gap" that would make repayment of the loan impossible. Bush ignored her chief operating officer's warnings that forecasts XSEL gave to Plaintiffs were too high and thwarted his attempts to lower them.

Bush also lied about XSEL's relationship to the businesses that were supposedly the source of its revenue. While Bush assured Plaintiffs and other investors that XSEL had "effective control" of these businesses, she admitted privately that, in fact, XSEL had "ineffective control." Internal XSEL

correspondence proves that Bush knew the businesses did not consider XSEL's ownership to be "legitimate" and that Bush had no idea what the businesses were even doing. XSEL's former general counsel now admits that Bush lied to investors when she told them that XSEL controlled its Chinese businesses.

Bush also falsified XSEL's filings with the Securities and Exchange Commission. She concealed from Plaintiffs and XSEL's shareholders that XSEL's businesses booked unearned future revenue to artificially boost their earnings, and also concealed "fake expenses," "kickbacks," "numbers [that] weren't real," and other financial wrongdoing.

Not long after receiving the loans, Bush admitted that XSEL was "dangerously close to going under," and would need to breach its contractual obligations and conduct a fire sale of its few profitable assets to remain solvent. XSEL went bankrupt anyway. The vast majority of the loans were never repaid, and Plaintiffs sued Bush for fraudulent inducement.

However, despite the substantial evidence of Bush's fraud, the lower court (Ramos, J.) inexplicably awarded summary judgment to Bush and dismissed Plaintiffs' claims. To reach this result, the court violated the most fundamental principles of summary judgment. It did not require Bush to make *any* showing as the summary judgment movant. The court instead dove right into Plaintiffs' evidence like a factfinder with a predetermined outcome in mind. It ignored most

of the evidence Plaintiffs submitted, and as for the rest, the court drew inference upon inference in Bush's favor. Worse, the inferences drawn by the court were irrational. A jury not only *could* disagree with the lower court's improper factual findings, but for many of them, that is the *only* result a rational jury could reach.

The lower court spurned the black letter prohibition on factfinding in a summary judgment motion. Instead, its decision reflects the court's previously expressed and misguided view that summary judgment is the "equivalent of a trial on papers."[1] Plaintiffs are entitled to have their claims tried before the rightful factfinder—a jury of their peers. The lower court's summary judgment award should be reversed.

QUESTIONS PRESENTED

1. Does a summary judgment movant bear the initial burden to submit evidence demonstrating the absence of any material factual disputes?

The lower court answered no.

2. May a court weigh the evidence and make credibility determinations in adjudicating a summary judgment motion?

The lower court answered yes.

3. Must a court reviewing a summary judgment motion draw all reasonable inferences in the non-movant's favor?

[1] *People v. Greenberg*, No. 401720/2005 (N.Y. Sup. Ct.) (Ramos, J.), Transcript of Proceedings dated April 20, 2010, at 81.

The lower court answered no.

4. Where a plaintiff proffers evidence that the defendant's representations were knowingly false, and that the plaintiff relied on those representations to its detriment, may the lower court ignore that evidence and decide as a matter of law that no issues of material fact exist?

The lower court answered yes.

STATEMENT OF FACTS

A. The Parties

Plaintiffs are investment funds managed by affiliates of the private equity firm Patriarch Partners, LLC ("Patriarch"). Lynn Tilton is Patriarch's founder and Chief Executive Officer. (A615, ¶ 1).

XSEL was a Cayman corporation that operated "a wide range of media assets" in China. (A1067-83; A2707). Bush founded XSEL in 2005, and the company expanded quickly after its formation by acquiring Chinese media businesses. (A1067; A1072; A1076; A1085-87). Some of these acquisitions required XSEL to make post-acquisition payments, known as "earnouts," to the selling shareholders. (A1105-27). The size of the earnout payments depended on how the business performed after XSEL acquired it. (*Id*.).

Based on its perceived initial success, XSEL went public in 2007, and was traded on NASDAQ with an initial market capitalization of approximately $1

billion. (A2590/51; A2598/85). Bush, who invested none of her own capital in the company, earned $9.75 million through the sale of shares at the IPO. (A2641/244).

Beginning in 2008, XSEL's management team consisted of Bush as CEO, Andrew Chang as Chief Financial Officer, Zhu Shan as Chief Operating Officer, and John McLean as general counsel. (A2626-27/187-88; A1097). Al Lawn chaired XSEL's audit committee. (A1098).

B. Plaintiffs Loaned $57.8 Million To XSEL

On October 21, 2008, Plaintiffs agreed to loan XSEL $40 million to finance the acquisition of various television assets in China (the "Credit Agreement"). XSEL immediately drew down $33.2 million to acquire, among other things, an interest in All Sports Network ("ASN"), a high definition sports channel broadcasting in Asia. (A263; A2734-35; A2736-40).

Bush soon requested additional financing to acquire the rights to provide services and content for Shanxi Satellite TV ("SXTV"), a Chinese satellite television channel. On March 6, 2009, the parties amended the Credit Agreement to increase the loan amount by $17.8 million to a total of $57.8 million ("Amendment 1"). (A374-76). On March 10, 2009, XSEL drew down the remaining balance available under the $57.8 million loan. (A569-71).

C. Bush Falsified XSEL's Financial Forecasts To Induce The Loans

XSEL's financial outlook was vitally important to Plaintiffs in assessing whether XSEL could repay the loans. Plaintiffs therefore sought and received financial forecasts from Bush in advance of the loans, and bargained for a representation and warranty in the Credit Agreement that these projections were made in "good faith." (A204, § 4.1(hh); A361, § 4(a)).

Plaintiffs did not get what they bargained for. Bush knew that XSEL's prospects were bleak, as reflected in various undisclosed internal forecasts. Instead of revealing these forecasts to Plaintiffs, Bush manufactured a series of inflated projections that concealed XSEL's true financial condition. These falsified projections included: (a) an October 7, 2008 "worst case" scenario prepared by Bush and CFO Chang; (b) March 6, 2009 projections that Bush certified as "true, correct and complete"; and (c) projections for the television assets XSEL acquired using funding from Plaintiffs.

1. Bush Falsified The October 7, 2008 "Worst Case" Scenario

Plaintiffs received projections on October 7, 2008, before the Credit Agreement was signed, which purported to show XSEL's "worst case" scenario. (A640, A647-49). These projections predicted favorable results across a variety of metrics, including revenue, net income, and earnings before interest, taxes, depreciation and amortization ("EBITDA"). (A647). The "worst case" scenario

also projected positive cash balances—approximately $2 million in 2009, $28 million in 2010, and $56 million in 2011—to alleviate any concern about XSEL's ability to repay the loan. (A649; A2488-90).

Bush prepared these projections with CFO Chang, and presented them to Plaintiffs in order to obtain the Credit Agreement. (A1132-33; A1134-35; A2746/77-78; A2761/185-86). Bush "swore up and down" that "the worst-case scenario was very unlikely but would be the worst case . . . ." (A2746/77-78; A2761/185-86). Indeed, Bush indicated that the worst case cash balance for 2009 was actually higher than the $2 million set forth in the "worst case" model. (A1136). As Bush later confirmed in an email to CFO Chang, although the "worst case" scenario projected a $2 million cash balance for 2009, she "told Lynn [Tilton of Patriarch] that we would agree to go no lower than $5 [million]" for 2009. (*Id.*).

Bush knew that these assurances were false. She concealed from Plaintiffs an internal forecast predicting the substantial cash deficit that would ultimately destroy the company from Plaintiffs. Chang sent Bush this secret forecast in an email dated August 21, 2008, which predicted that XSEL would experience a "funding gap" in the range of "[$]30-40 mn." (A767). Bush testified at her deposition that the $30-40 million funding gap—and not the cash-positive scenario XSEL gave to Plaintiffs—was the "worst case scenario." (A2672/368). In other words, when Bush told Plaintiffs that XSEL would be cash positive even in the

"worst case" scenario, she was clearly lying; she knew of a large anticipated cash shortfall that she now admits was the real worst case. (*See* A1145; A2488-90).

2. Bush Falsified the March 6, 2009 Projections

XSEL sent Plaintiffs updated projections on March 6, 2009, to induce Amendment 1. (A2771, A2782). These upbeat projections, like the prior ones, were intended to show that the loan could be repaid. Bush personally assured Plaintiffs that the updated forecast was "true, correct and complete." (A2775-77, A2782; *see also* A2843).

The opposite was true. The projections Bush gave to Plaintiffs were contradicted by yet another internal forecast that Bush concealed. Specifically, on February 24, 2009, Bush received from CFO Chang projections entitled "X[SEL] Internal Numbers" that were substantially lower than the numbers given to Plaintiffs:

USD millions	**3/6/2009 Projections Given to Plaintiffs**[2]	**2/24/09 "X[SEL] Internal Numbers"**	**Difference**
Revenue	$232.0	$175.7	$56.3
EBITDA	$26.1	$7.5	$18.6
Net Income	($7.1)	($31.1)	$24.0

[2] The March 6, 2009 projections were even higher than this chart indicates. Plaintiffs' accounting expert adjusted these projections downward to account for the two XSEL businesses that were included in the March 6, 2009 projections but excluded from the February 24, 2009 model. (A2791).

(A1157; A2497; A2791; A2855/191-92).

At her deposition, Bush was unable to explain this discrepancy. (*See, e.g.*, A2618-20/163-71). At first she claimed that the "Internal Numbers" in the February 24, 2009 document originated with third party research analysts and did not reflect XSEL's internal assessment. (A2618-19/165-67). Bush later abandoned this claim because, in fact, the "Internal Numbers" were exactly what their title would suggest—XSEL's internal assessment, which Bush concealed from Plaintiffs. (A2494-95).

3. Bush Falsified The Forecast For The Television Acquisitions

Bush also falsified projections for the Chinese television assets XSEL acquired using Plaintiffs' financing. (*See, e.g.*, A3241, A3243, A3247; A2168, A2178, A2184; A2802; A2778). For example, Bush represented to Plaintiffs that SXTV would yield $6.1 million of EBITDA in 2010. (A2801-02). Shan later informed Bush that "[b]ased on discussion[s] with SXTV . . . we need to do some adjustment to the numbers," including a downward revision of 2010 EBITDA from $6.1 million to $1.5 million. Bush responded, "Why is 2010 so low? She [*i.e.*, Ms. Tilton] will never accept that 2010 goes from 6.1 to 1.5." (A1164). Bush never told Plaintiffs the SXTV projections had been lowered. Instead, she later re-affirmed the inflated $6.1 million figure in communications with Plaintiffs to induce the funding. (A2771, A2775-78).

Similarly, Bush concealed from Plaintiffs the forecast for ASN provided by ASN's shareholders, which predicted meager earnings and a cash deficit through 2011. (A1169, A1171-72). Bush instead instructed CFO Chang to give Plaintiffs a forecast with stronger earnings and positive cash. (A1203-06). Bush did not instruct Chang to alert Plaintiffs that the rosy forecast they received was not the actual ASN forecast.

D. Bush Misrepresented XSEL's Control Of Its Businesses

Bush also misstated XSEL's control of its Chinese businesses. Although XSEL had direct equity control over some of the businesses, for others Chinese law prohibited direct ownership. (*See, e.g.*, A1085-92). XSEL used what is commonly known as a "nominee shareholding" structure for the businesses it did not directly own. For these businesses, XSEL nominated Chinese citizens to hold the equity in the business (the "nominee shareholders") and contracted with the nominees to act at XSEL's behest (the "Internal Control Agreements"). (A1091). The nominee shareholding structure is widely used by U.S.-listed companies with operations in China. (A2901, A2928; A1299/87-88).

Plaintiffs sought and received Bush's assurance that XSEL controlled its Chinese businesses before loaning the money to XSEL. In communications with Plaintiffs, Bush was "adamant that XSEL had complete control of both the operations and the finances of the businesses." (A616, ¶ 6; A2752/131-32;

A2755/145-46; A2758/159-60). She assured Ms. Tilton "not once, but tens of times, that [XSEL] had access to all the cash at these operating entities . . . and that she had complete control over the operations, the employees, and the management teams." (A2758/159-60).

Bush reiterated these representations in XSEL's annual filings with the SEC on SEC Form 20-F. There, Bush claimed that XSEL had "effective control" over the Chinese businesses. (A1091). XSEL's witnesses confirmed that when Bush claimed XSEL had "effective control," she meant that XSEL was actually in control of the businesses' operations. For example, audit committee chair Al Lawn testified that "effective control" meant that XSEL "had control over the businesses. They could tell them to start selling widgets. They could tell them to do X, Y, Z." (A1226/192). The 20-Fs also assured investors that because XSEL "effectively controlled" the businesses, it "c[ould] direct the use of their cash." (A1096). Bush sent Plaintiffs XSEL's 20-F for the year ended December 31, 2007 (the "2007 20-F") for the purpose of inducing the loans (A2857-58), and represented in the Credit Agreement that the 2007 20-F did not "contain[] any untrue statement of a material fact" or "omit[] to state a material fact . . . ." (*See, e.g.*, A198-99, §§ 4.1(p)(ii)-(iii); A361, § 4(a); A616, ¶ 6).

Contrary to her representations, Bush knew that XSEL did not control its businesses. Bush never asked XSEL's nominee shareholders to assert control of

the businesses on XSEL's behalf. (A2663/332-33). Bush did not even know who the nominee shareholders were, even though XSEL should have been controlling the businesses through these shareholders. (*Compare* A2663/333-35, *and* A2681-82/405-07, *with* A1091-92, *and* A1801-02). Indeed, neither Bush nor her management team even knew what was happening at the businesses. As COO Zhu Shan lamented to Bush in September 2007:

> We don't know when key employees of subsidiaries resigned or hired, we don't know if a subsidiary opened or shut down a company until the last minute. More than often we are informed of signing of some very big contracts without knowing the terms, rather than being involved from the beginning.

(A1333-34). Because of XSEL's lack of managerial oversight, the Chinese businesses did not perceive XSEL's ownership to be "legitimate." (A1337).

Houlihan Lokey, an advisor to XSEL, confirmed in 2010 that the businesses' Chinese operators were in "de facto control" because of XSEL's "lack of effective managerial control systems." (A781). McLean, XSEL's general counsel, indicated that this conclusion applied equally in 2008 when Plaintiffs made the loan to XSEL; according to McLean, if anything, XSEL's controls were better in 2010 when Houlihan found them ineffective than they had been in the earlier years before the loan. (A1311/102-105).

Houlihan also concluded that, on top of the mismanagement, XSEL had "ineffective control" over some businesses because it was not making earnout

payments to the business operators on time, thereby straining XSEL's relationship with them. (A868). Bush herself conceded that "[w]hen XSEL was not able to make its earnout payments, the relationship between the parent and the subsidiaries was very difficult." (A2649/278-79). Bush knew that the relationship became "difficult" by early 2008, when XSEL began delaying and discontinuing the earnout payments. (*See, e.g.*, A2933 (Bush stating in April 2008 that that "[r]umors are now rampant at X[SEL] that we are not good for the earnouts."); *see also* A1341 (business owner complaining about missed earnout payment in August 2008 and stating "I don't have any idea about the actual earnout payment status"); A1342 (Bush stating in November 2008 that for two businesses, "there is no money for their earnout")).

Bush "approved" Houlihan's conclusion that XSEL lacked control of the businesses, and no one at XSEL disagreed. (*See, e.g.*, A769-72, A781; A853-56, A868; A1343-46, A1355; A1428-29; A1430-31; A1432-35, A1442; A1570-74, A1583; A1718-20; A2636/226-27, A2638/232-33, A2646/266-67; A1316/136-37). General counsel McLean confirmed that Houlihan's findings contradicted Bush's public assurances that XSEL controlled its businesses. He testified that Houlihan's conclusion that the Chinese operators were in "de facto control"—a conclusion that Bush "approved" but concealed from investors—was "not consistent" with Bush's

public statement that XSEL had "effective control over its affiliated entities." (A1316-17/136-39).

Alixpartners, another financial advisor hired by XSEL in late 2010, reached the same conclusion as Houlihan—that there were "[p]roblems with control over a multitude of [XSEL] subsidiaries." (A2934). For example, Alixpartners concluded that XSEL had "*never* exercised [its] rights" to obtain control over certain businesses. (A3185 (emphasis added)).

The evidence is therefore overwhelming—and plainly more than sufficient to survive summary judgment—that Bush lied to Plaintiffs and other investors when she claimed that XSEL had control over its businesses in 2008.

E. Bush Falsified XSEL's Historical Financials To Induce The Loan

Bush also falsified the historical financial information that XSEL provided to Plaintiffs in advance of the loan. The Sarbanes-Oxley Act of 2002, which penalizes a public company's CEO with up to 20 years' imprisonment for intentional misstatements, governed XSEL's annual submissions to the SEC on Form 20-F. *See, e.g.*, 18 U.S.C. § 1350. As required by Sarbanes-Oxley, Bush personally certified that XSEL's 20-Fs did "not contain any untrue statement of a material fact" and "fairly present[ed] in all material respects" XSEL's "financial condition and results of operations." (A1128, A1130). As noted above, Bush gave Plaintiffs XSEL's 2007 20-F to induce the loans (A2857-58), and Plaintiffs

bargained for a representation and warranty that the 20-F was accurate. (*See, e.g.*, A198-99, § 4.1(p)(ii)-(iii); A361, § 4(a)). Plaintiffs relied in particular upon Bush's representations regarding the accuracy of XSEL's financial reporting. (A617, ¶ 8; A2758-59/160-61).

In fact, Bush and her management team falsified XSEL's financial reporting by treating unearned future earnings as current revenue. For example, on November 22, 2007, COO Shan admitted to Bush that "[t]he following explains the weaker Q4 [2007] . . . . Quite a lot of biz units moved their revenue to Q3 to drive up Q3 number." (A1218-19; *see also* A1221). Bush concealed this fraudulent practice from Plaintiffs and other investors. (*See, e.g.*, A1243-44/595-96; A1251). She also concealed the reporting of "fake expenses," revenues that "were not recorded in the books and were used to pay kick-backs," account balances that "could not be reconciled with each other," and other "improper management of accounting books and records." (A1271, A1290; A2872; A2122-23, A2133).

Put simply, XSEL's SEC filings did not "fairly present" the company's financial condition, and Bush intentionally misled Plaintiffs when she claimed otherwise.

F. The Fraud Was Revealed After XSEL Received The Funding

Bush's story began to unravel soon after XSEL received the funding on March 10, 2009. In the following months, as more evidence of her malfeasance surfaced, it became increasingly clear that Fredy Bush had defrauded the Plaintiffs.

1. XSEL Revealed A Cash Shortfall Soon After The Funding Of Amendment 1

On March 15, 2009—five days after the loan was complete—Bush sent Plaintiffs an updated set of projections. (A1721-33). These projections were a far cry from the forecast Bush had certified for Plaintiffs on March 6, 2009, immediately prior to the funding:

USD millions	**3/6/2009 Pre-Funding Projections**	**3/15/09 Post-Funding Projections**	**Difference**
Revenue	$266.9	$168.5	$98.4
EBITDA	$42.3	$17.1	$25.2
Net Income	($3.3)	($22.7)	$17.0

(A1722; A2497-98). At her deposition, Bush was unable to explain why she waited until after the loan to revise the projections downward. She testified that she did so in response to the enactment of a "new regulatory structure" in China. (A2620/172-73; A2674-76/375-85). This testimony was false. The new regulatory structure was not enacted until October 2009, six months *after* Bush sent the new projections. (A1734). There is no legitimate explanation for why the projections shown to Plaintiff changed so dramatically after the loan was funded.

In reality, Bush deliberately concealed the real projections until she had Plaintiffs' money in hand.

On May 5, 2009, CFO Chang confirmed that a substantial "cash shortfall" was imminent. (A2936 ("XSEL will run into cash shortfall of US$13 mn by June 2009 . . .")). Bush herself admitted that XSEL was "dangerously close to going under." (A1736). Publicly, Bush blamed XSEL's decline on general economic conditions and, later, the regulatory changes in China. (A1749-50; A1734). Privately, when asked whether "the Company's financial performance deteriorated in 2009" "due to the economic downturn and regulatory changes," Bush responded, "I'm not sure this is a true statement." (A1428).

2. Bush Fraudulently Induced The Economic Observer Consent

XSEL relied on stopgap measures to stay afloat in 2009, such as the nonpayment of its earnout obligations and a $7.5 million capital raise—despite the assurances in the "worst case" model given to Plaintiffs that such measures would be unnecessary to maintain a positive cash balance. (*See, e.g.*, A1770-80; A1781-82; A644; A2769-70/348-52; A2959-61).

XSEL also proposed selling its "Economic Observer" business to raise cash. Economic Observer was a print media business operating through two Chinese subsidiaries known as "Jingshi Jingguan" and "Beijing Jingguan Xingcheng Advertising." (A1068; A1079). Under the Credit Agreement, XSEL needed

Plaintiffs' consent to sell Economic Observer. (A1785; A217, § 6.1(g)). On May 12, 2010, Plaintiffs and XSEL executed a "Consent to Credit Agreement" (the "Consent") in which Plaintiffs formally consented to the sale of Economic Observer to a third party buyer. (A2534).

To induce the Consent, Bush represented to Plaintiffs that "there are no material claims pending, proposed or threatened" by the Chinese government for "past Taxes" owed by Economic Observer. (A203, § 4.1(dd)(ii); A2539, § 10). Bush also represented that Economic Observer had been "granted exemptions from enterprise income tax for . . . 2007." (A198-99, § 4.1(p)(ii); A2539, § 10; A1804). The Chinese government allowed such exemptions for "newly established domestic companies that are . . . in the information industry[] or are cultural media enterprises." (A1804). Economic Observer relied upon this purported exemption to shield its 2007 income from taxation. (*Id*.).

Bush knew that her representations were false because the Chinese government had already rejected Economic Observer's claim to an exemption and demanded payment of back taxes. Specifically, in November 2008, the Chinese State Administration of Taxation's Beijing Fangshan District Office (the "Tax Administration") ruled that Economic Observer was not a "newly established domestic company," which meant that its "whole income from advertising business in 2007 [was] not entitled" to the exemption for new enterprises. (A1837-42). The

Tax Administration ordered Economic Observer to "make a full additional payment" of the unpaid amount. (A1839; *see also* A1842). Economic Observer concluded that this tax assessment would "damage[]" its "operation . . . so seriously that we may encounter the danger of bankruptcy." (A1844; A1848). Bush was well aware of the Tax Administration's ruling and approved the engagement of a tax consultant to address it. (A1810). Yet she concealed the tax assessment from Plaintiffs and other investors. (A2686/424).

3. Houlihan Lokey Uncovered Improprieties at XSEL

Meanwhile, Plaintiffs asked XSEL to hire a financial advisor to address their concerns about XSEL's lack of transparency and its need for operational support. (*See, e.g.*, A2999; A3009). XSEL engaged Houlihan Lokey in April 2010. (A1889-93; A2024). After examining the business, Houlihan identified a host of serious managerial deficiencies at XSEL. (*See, e.g.*, A779; A781; A803; A810-14; A868-69; A887; A898; A915; A1895). The financial improprieties that Houlihan uncovered were especially troubling. Houlihan found that "areas of controlling and reporting [were] nonexistent" and "nobody kn[ew] . . . where [the numbers] c[a]me from" at XSEL. (A3010; A3013-15/548-55). Because of its deficient financial oversight, XSEL did "not have timely and accurate financial reports." (A898, A915 (concluding that XSEL's financial management had yet to "reach the standards required by U.S. security authorities")). Houlihan also revealed that

XSEL "did not have [a] budget process in place" and "lacked a long term financial forecast"—even though XSEL had given supposed long term forecasts to Plaintiffs in order to induce the loans. (A3010; A3013-15/548-55; A803).

Bush "approved" Houlihan's conclusions (A769-72, A779, A781, A803, A810-14; A853-56, A868-69, A887, A898, A915; A1343-46, 1353, 1355, 1377, 1384-88; A1428-29; A1430-31; A1432-35, 1442-43, 1458, 1463; A1570-74, 1582-83, 1599, 1604; A1718-20; A2636/226-27, A2646/266-67), and no one at XSEL disagreed with them (A2637/231; A2646-47/266-69; A1308-09/28-31).

Houlihan discovered other misdeeds during its engagement. For example, SXTV terminated its contract with XSEL because "XSEL had defaulted on one or more of th[e] payments" it owed. (A1904/232; *accord* A1930-33). Days before the termination, XSEL delivered to SXTV $2.6 million in funds that were contractually owed to Plaintiffs, even though this payment did not prevent SXTV from terminating its agreement with XSEL. (A2699/475-76). XSEL then lied to NASDAQ about the SXTV termination, claiming that XSEL, not SXTV, had "terminated its advertising agency agreement with [SXTV]" in order to "improve its financial and operational performance and reduce its cost structure." (A1940).

4. Fredy Bush's Disappearance

Soon after Houlihan's engagement, Fredy Bush disappeared. She spent two months in Hawaii beginning in May 2010. (A2644-45/259-60). Though she

returned to XSEL periodically thereafter, she "never went back to China to work on a full-time basis," and spent "most of [her] time in Hawaii." (A2703-04/492-94). Bush admits that she was "absent," wasn't "giving [XSEL] my attention" and spent "minimal" time carrying out her responsibilities as CEO of XSEL.[3] (A2648/275; A2653/292-93; A2703-04/493-94). General counsel McLean conceded that XSEL might have benefitted from a new CEO. (A1324-25/240-42).

5. XSEL Restructured Its Debt To Plaintiffs

XSEL told Plaintiffs that it would not survive without additional financing from Plaintiffs. (*See, e.g.*, A3023). Plaintiffs had serious reservations about reinvesting, in light of their concerns about XSEL's mismanagement and lack of transparency. (*See, e.g.*, A3255; A3262; A3264). Plaintiffs agreed to make one final $7.6 million loan in July 2010, but only on the condition that XSEL immediately repay $16.3 million of the $57.8 million owed under the original loan. (A1917). The parties completed these transactions simultaneously on July 12, 2010. (*Id.*). Because XSEL's repayment ($16.3 million) exceeded the amount of the new loan ($7.6 million) by $8.7 million, the transaction had the effect of reducing XSEL's overall debt to approximately $49 million. XSEL never repaid

[3] Bush attributes her absence to an alleged problem with her eye and to the health of her grandson. (A2703-04/493-94; A2704-05/497-98). She claims that she offered to resign in 2010 (A2704/495), but there is no evidence to support this claim.

the $49 million that remained owing to Plaintiffs, even as Bush continued to engage in self-dealing to deprive XSEL of its few remaining assets.[4]

6. Alixpartners Replaced Houlihan And Uncovered Additional Improprieties

In October 2010, Houlihan discontinued work for XSEL because, despite "repeatedly receiv[ing] [Bush's] personal assurances that [it] would be paid," those assurances turned out to be "regrettably misplaced." (A1925; A1901-03/220-25). Because Bush had retreated to Hawaii and was not in China running her company, Plaintiffs requested that XSEL hire a new financial advisor experienced in turning around distressed companies.

XSEL hired Alixpartners in November 2010. (A3064-65/33-35). Soon after its retention, Alixpartners began echoing Houlihan's concern that XSEL's financial forecasts were "routinely not reliable" and were "not reflecting . . . reality." (A3093; A3098; A3069-70/93-96).

New evidence of Fredy Bush's wrongdoing also came to light. For example, XSEL was owed approximately $60 million by the owners of a company called Convey. (A1922-23). In August 2010, at a time when it desperately needed the

[4] Specifically, the "bridge loan" Bush personally extended to XSEL in 2010 was repaid within three months. Pursuant to that loan, Bush was granted an additional 6 million XSEL shares over the objection of her audit committee chair. (A1920; A1238/561-63). She told investors that the shares were "restricted" and "may not be sold prior to April 2, 2015." (A1920). But in a secret meeting of XSEL's compensation committee, "it was decided that the restriction on trading imposed on the 6,000,000 shares . . . be lifted with immediate effect." (A3061).

cash, XSEL inexplicably entered a settlement agreement with Convey's owners pursuant to which XSEL relinquished its right to the $60 million in exchange for equity in a valueless shell company. (A3487-88, ¶¶ 301-303). In other words, XSEL simply abandoned its rightful claim to $60 million cash and received nothing in return. Bush claims not to know why this happened (A2691-95/445-58), but she concealed the transaction from Plaintiffs in violation of the Credit Agreement's disclosure requirements. (*See* A400, § 2(f)).

G. XSEL Became Insolvent And Bush Pleaded Guilty To A Federal Felony

XSEL entered liquidation in April 2011. (A1947-48). Forty-nine million dollars in principal and millions more in interest remain owing to Plaintiffs under the Credit Agreement. Because Bush squandered nearly all of XSEL's assets, Plaintiffs recovered a mere $240,843 of their losses as the senior secured creditors in XSEL's liquidation proceedings. (A1964; A1952).

On May 10, 2011, Bush was indicted in the U.S. District Court for the District of Columbia for wrongdoing related to Xinhua Finance Limited, XSEL's former parent company. (A2029-67). Bush's criminal co-defendants were Dennis Pelino and Shelly Singhal. In May 2013, all three Defendants pleaded guilty and were sentenced to prison. (A2687-88/429-33).

Unbeknownst to Plaintiffs, Pelino and Singhal looted XSEL prior to its liquidation. Bush claimed at her deposition that Pelino "did not have a role in

XSEL" (A2581/15-16) when, in fact, she personally involved him in many aspects of XSEL's operations. (A3492-93, ¶ 325). With Bush's blessing, Pelino funded his extravagant lifestyle on XSEL's dime, and was reimbursed for (among other things) lavish hotel stays, first class airfare, "beauty salons," $700 dinners, and nearly $20,000 in dental work. (*Id.*).

Singhal resigned as CFO of XSEL on May 19, 2007 amid allegations of self-dealing. (A2148; A1234/304). Although he was "not to be involved with the company" after his departure (A1238/560), Bush maintained a clandestine role for him. (*See, e.g.*, A2096-97 (inflated ASN projections edited by Shelly Singhal); *see also* A3493, ¶ 326). XSEL also continued to divert funds for Singhal's personal use long after his 2007 resignation. (A3493, ¶ 326).

H. The Lawsuit And The Lower Court's Summary Judgment Opinion

Plaintiffs brought this action on May 27, 2011, alleging fraud and negligent misrepresentation against XSEL, Bush, CFO Andrew Chang, and general counsel John McLean. McLean was subsequently dismissed from the case, and neither XSEL nor Chang has appeared. Plaintiffs' negligent misrepresentation claims against Defendants were also dismissed. Thus, the action now centers on Plaintiffs' allegations of fraud against Bush.

After the close of discovery, on April 21, 2014, Bush moved for summary judgment. Plaintiffs opposed the motion by identifying four categories of

fraudulent misstatements: (1) the falsified projections; (2) the misrepresentations concerning XSEL's control of its businesses; (3) the falsified financial reporting in XSEL's SEC filings; and (4) the misrepresentations concerning Economic Observer's tax liabilities.

In a memorandum and order dated January 15, 2015, the lower court granted Bush's motion and dismissed the fraud claims against her (the "Summary Judgment Order"). (A6-18). The court articulated the standard for adjudicating summary judgment as follows: "a party opposing a motion for summary judgment must produce evidentiary proof in admissible form sufficient to require a trial of material questions of fact on which he rests his claim . . . . [M]ere conclusions, expressions of hope or unsubstantiated allegations or assertions are insufficient." (A11). Nowhere did the opinion acknowledge that Bush bore the initial burden of proof as the movant, or that the court must refrain from making credibility determinations and drawing factual inferences in the movant's favor.

The Summary Judgment Order does not address Plaintiffs' claim that Bush misstated XSEL's financial reports. As for the remaining alleged misrepresentations, the lower court held that there were no material issues of fact requiring a trial. In so ruling, the court completely ignored most of the evidence Plaintiffs submitted to the Court in opposing summary judgment.

On January 22, 2015, Plaintiffs filed a timely notice of appeal from the Summary Judgment Order. This appeal followed.

LEGAL STANDARDS

To establish their claim for fraudulent inducement, Plaintiffs must demonstrate by clear and convincing evidence (1) a false representation of material fact, (2) scienter, (3) justifiable reliance on the representation, and (4) resulting injury. *Pramer S.C.A. v. Abaplus Int'l Corp.*, 76 A.D.3d 89, 98 (1st Dep't 2010); *Fleet Factors Corp. v. Van Dorn Retail Mgmt., Inc.*, 180 A.D.2d 556, 557 (1st Dep't 1992). "[A] plaintiff may establish the second element . . . by showing that the defendant knew the representation was untrue or made it with reckless disregard for the truth." *Wilson v. Thorn Energy, LLC*, 787 F. Supp. 2d 286, 294 (S.D.N.Y. 2011); *accord Jo Ann Homes at Bellmore, Inc. v. Dwortez*, 25 N.Y.2d 112, 119 (1969). Whether the defendant had the requisite knowledge of the misstatement, and whether the plaintiff justifiably relied on it, are "ordinarily question[s] of fact which cannot be resolved on a motion for summary judgment." *Shisgal v. Brown*, 21 A.D.3d 845, 847 (1st Dep't 2005) (citation omitted); *Brunetti v. Musallam*, 11 A.D.3d 280, 281 (1st Dep't 2004).

This Court reviews *de novo* a lower court's grant of summary judgment under CPLR 3212. *See, e.g., Duane Reade, Inc. v. Cardtronics, LP*, 54 A.D.3d 137, 140 (1st Dep't 2008). On a motion for summary judgment, the moving party

bears the initial burden of setting forth in the first instance "sufficient evidence to demonstrate the absence of any material issues of fact." *Vega v. Restani Constr. Corp.*, 18 N.Y.3d 499, 503 (2012) (citation omitted). "This burden is a heavy one," and "[w]here the moving party fails to meet this burden, summary judgment cannot be granted, and the non-moving party bears no burden to otherwise persuade the court against summary judgment." *William J. Jenack Estate Appraisers & Auctioneers, Inc. v. Rabidzadeh*, 22 N.Y.3d 470, 475 (2013).

Even if the moving party satisfies its burden, a court may grant summary judgment "only if . . . the non-moving party fails to establish the existence of material issues of fact which require a trial of the action." *Vega*, 18 N.Y.3d at 503 (citation omitted). In making this determination, the "facts must be viewed in the light most favorable to the non-moving party." *Id.* (citation omitted); *see also Morris v. Lenox Hill Hosp.*, 232 A.D.2d 184, 185 (1st Dep't 1996). "'Credibility determinations [and] the weighing of evidence . . . are jury functions, not those of a judge . . . .'" *Asabor v. Archdiocese of New York*, 102 A.D.3d 524, 527 (1st Dep't 2013) (quoting *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255 (1986)). "Summary judgment should not be granted where there is any doubt as to the existence of a factual issue or where the existence of a factual issue is even 'arguable.'" *Asabor*, 102 A.D.3d at 527; *see also Glick & Dolleck, Inc. v. Tri-Pac Export Corp.*, 22 N.Y.2d 439, 441 (1968) (same).

ARGUMENT

The lower court broke two cardinal rules of summary judgment in granting Bush's motion. First, the court never required Bush, as the moving party, to meet her burden to show that she is entitled to summary judgment—a burden that Bush had no prayer of satisfying. The lower court instead held that "a party *opposing* a motion for summary judgment" has the initial burden of producing "evidentiary proof . . . sufficient to require a trial." (A11 (emphasis added)). The court thus inverted the summary judgment standard and erroneously granted summary judgment without requiring Bush to make any showing at all. *See William J. Jenack*, 22 N.Y.3d at 475 ("[T]he moving party's failure to make a prima facie showing of entitlement to summary judgment requires a denial of the motion, regardless of the sufficiency of the opposing papers.").

This error alone did not carry the day, however, because even though the initial burden of proof should have belonged to Bush—and Bush cannot meet that burden—Plaintiffs easily satisfied the initial burden that the lower court incorrectly imposed on them. It was a second, more fundamental error that resulted in the summary judgment award: the lower court's refusal to view the facts "in the light most favorable to the non-moving party," *Vega*, 18 N.Y.3d at 503 (citation omitted), and to defer "the weighing of the evidence[] and the drawing of legitimate inferences" to the jury, *Asabor*, 102 A.D.3d at 527. The lower court

hijacked the factfinding process, drawing numerous factual inferences in Bush's favor and ignoring most of the inculpatory evidence.

These errors pervaded the court's summary judgment opinion. Bush fraudulently induced the loan agreements by: (I) falsifying the projections given to Plaintiffs; (II) misrepresenting XSEL's ability to control its businesses; (III) misreporting XSEL's financial results; and (IV) misrepresenting XSEL's tax liabilities. The lower court failed even to address the misreporting of XSEL's financial results. As to the remaining misrepresentations, the court bent over backwards to disregard, minimize, or outright ignore the evidence marshalled by Plaintiffs and the reasonable inferences a jury could draw therefrom. Had the court properly applied the summary judgment standard, it would have denied Bush's motion, both because she failed to demonstrate by record evidence that she was entitled to summary judgment, and because Plaintiffs' own evidence showed that, at a bare minimum, material issues of fact remain to be decided at trial.

I. There Are Disputed Issues Of Fact Concerning Bush's Falsification Of The Projections

Bush falsified the key projections on which Plaintiffs relied in loaning the money to XSEL, including (1) the October 7, 2008 "worst case" scenario, (2) the March 6, 2009 projections and (3) the projections for XSEL's acquisitions. Nowhere in these rosy forecasts was there any hint of the imminent cash crisis that Bush anticipated. Bush concealed the internal projections that reflected XSEL's

looming bankruptcy because she knew that giving Plaintiffs the real projections would doom any chance of receiving the loans.

The lower court found the evidence insufficient to show that Bush knew the projections had been falsified or that Plaintiffs relied on them. In reaching these conclusions, the court improperly ignored inculpatory facts, "weigh[ed] . . . the evidence" and made "[c]redibility determinations." *Asabor*, 102 A.D.3d at 527. There is copious evidence from which a jury could readily conclude that Bush defrauded Plaintiffs by falsifying the projections.

A. Bush Knowingly Falsified the October 2008 "Worst Case" Projections

Bush falsified the "worst case" projections for the sole purpose of inducing the 2008 Credit Agreement. She created these projections with CFO Andrew Chang because Plaintiffs requested her assurance that XSEL would be able to repay the loan in the worst case scenario. (A1132-33; A1134-35; A2746/77-78; A2761/185-86). The projections offered that assurance, forecasting positive cash balances even in the "worst case." (A649; A2488-90). Bush repeatedly told Plaintiffs that she had "worked through the projected numbers" and "believed in them," and she "swore up and down" that "the worst-case scenario was very unlikely but would be the worst case . . . ." (A2746/77-78; A2761/185-86). Bush claimed that, if anything, the "worst case" projections were overly conservative. (A1136).

In fact, the "worst case" projections were a hoax. Internal XSEL projections, of which Bush was indisputably aware, warned of massive cash deficits. Chang sent Bush an email dated August 21, 2008 predicting that, as early as the first quarter of 2009, XSEL would experience a "funding gap" in the range of "[$]30-40 mn." (A767). Testifying about this email at her deposition, Bush conceded that Chang's forecast of a funding gap was the "worst case scenario[,] looking at what if we are not able to move the other assets or divest of them." (A2672/368).

Thus, when Bush told Plaintiffs that XSEL would be cash positive in the "worst case," she knew that XSEL's real worst case scenario involved a cataclysmic cash deficit. That is quintessential fraud. *See, e.g.*, *CPC Int'l, Inc. v. McKesson Corp.*, 70 N.Y.2d 268, 274, 285-86 (1987) (fraud alleged where defendants created "fictitious projections overstating . . . business prospects which [defendants] knew were at odds with the unfavorable projections" distributed internally); *E. 32nd St. Assocs. v. Jones Lang Wooton USA*, 191 A.D.2d 68, 71 (1st Dep't 1993) (denying summary judgment because "financial projections made with the knowledge that they were false and unreasonable may be the basis for an allegation of common law fraud"); *Lau v. Mezei*, No. 10 CV 4838 (KMW), 2012 WL 3553092, at *6 (S.D.N.Y. Aug. 16, 2012) (denying summary judgment where

defendant knew of companies' "financial insecurity" but represented to plaintiff that he "believed the investments were low risk").

In awarding summary judgment to Bush, the lower court disregarded Chang's "funding gap" email because it thought that the email was "submitted without context." (A12). But Bush represented to Plaintiffs that XSEL would be cash-positive in the "worst case" scenario, and the funding gap email on its face shows that Bush concealed another scenario involving a $30-40 million cash deficit. That is all the "context" a jury would need to conclude that Bush defrauded the Plaintiffs. Moreover, Plaintiffs did provide the additional "context" the court claimed was lacking—Bush's own inculpatory testimony about the funding gap email, which the lower court ignored. Bush admitted at her deposition that the $30-40 million funding gap—and not the cash-positive scenario given to Plaintiffs—was the real "worst case scenario."[5] From this evidence, it is not only *possible* for a rational jury to conclude that the projections were knowingly falsified, but that is the *only* rational inference it could draw.

[5] The lower court asserted that Plaintiffs were required to corroborate Bush's own dispositive admission with the testimony of a non-appearing defendant, Andrew Chang. (*Id.*). But the law provides otherwise. *See, e.g., 6243 Jericho Realty Corp. v. AutoZone, Inc.*, 27 A.D.3d 447, 449 (2d Dep't 2006) (holding that movant's "argument that [] testimony was incredible as a matter of law because it was not corroborated . . . is without merit" because "[o]n a motion for summary judgment the court must not weigh [] credibility").

B. Bush Knowingly Falsified The March 2009 Projections

The lower court also ignored the evidence showing that the March 6, 2009 projections were falsified. Bush knew that these projections were substantially higher than the "internal numbers" that CFO Chang sent her on February 24, 2009. (A1157; A2497; A2791; A2855/191-92). Bush defrauded Plaintiffs by certifying the inflated March 6 projections as "true, correct and complete" to induce the funding under Amendment 1. (A2771, A2775-77, A2782; *see also* A2843; A3354-55).

The lower court disregarded the February 24 "internal numbers" because they were supposedly "submitted without any context or explanation." (A13). Yet the projections on their face reveal that Bush induced the loan using a forecast that bore no relation to XSEL's "internal numbers." A jury would require no further "context" or "explanation" to conclude that Bush inflated the projections she gave to Plaintiffs in order to procure the loans. *See, e.g., CPC Int'l*, 70 N.Y.2d at 274, 285-86.

And the lower court again ignored Bush's inculpatory testimony about the concealed internal numbers. At her deposition, Bush could not explain why the projections given to Plaintiffs were so much higher. Her story was that the projections labeled "internal numbers" were not actually XSEL's internal numbers, and instead originated with third-party research analysts. (A2619-20/166-70).

Dubious on its face, this claim has since been proven false, and Bush has abandoned it. (A2494-95). Nor could Bush explain why on March 15, 2009—five days after XSEL received the final installment of the loan—she suddenly slashed the forecasts Plaintiffs had seen before the funding. (A1722; A2497-98). Bush testified that this happened in response to the announcement of a "new regulatory structure" in China. (A2620/172-73; A2674-76/375-85). In fact, as Bush herself confirmed in statements to the SEC, the new regulatory structure was not announced until *October* 2009, six months *after* Bush lowered the projections. (A1734).

A jury could readily conclude that, by attempting to rationalize the conflicting internal and external projections with more lies, Bush confirmed the absence of any legitimate explanation.[6] The lower court committed reversible error by ignoring this evidence, usurping the jury's role, and awarding summary judgment to Bush.

[6] After Bush's deposition, her lawyers conducted damage control by hiring an accounting expert to provide his own meritless justification for Bush's concealment of XSEL's "internal numbers." But a litigation expert lacking personal knowledge cannot testify to facts that his client—the party that does have personal knowledge—failed to supply under oath. *See, e.g.*, *Timmins v. Tishman Constr. Corp.*, 9 A.D.3d 62, 70 (1st Dep't 2004) (expert opinion that "guessed as to the cause" of accident could be disregarded on summary judgment). Certainly the factfinder is permitted to disregard the opinion of an expert that contradicts his client's own sworn testimony.

C. Bush Knowingly Falsified The Acquisition Projections

The evidence is equally clear that Bush falsified the projections for XSEL's television acquisitions. For example, Bush told Plaintiffs in December 2008 that the SXTV investment would yield $6.1 million of EBITDA in fiscal year 2010. On January 4, 2009, Chief Operating Officer Zhu Shan emailed Bush to inform her that, "[b]ased on discussion with SXTV last week, we *need* to do some adjustment to the numbers." (A1164 (emphasis added)). Shan's email set forth both the "[p]revious version" of the projections that had been "submitted to [Plaintiffs]," and the "[l]atest version" reflecting Shan's discussion with SXTV. (*Id.*). The revised forecast lowered the SXTV projections for 2010, 2011, and 2012. (*Id.*). The downward adjustments for 2010 were especially notable, including a reduction of 2010 EBITDA from $6.1 million to $1.5 million. (*Id.*).

Bush responded to Shan's email as follows: "Why is 2010 so low? She [*i.e.*, Lynn Tilton] will never accept that 2010 goes from 6.1 to 1.5." (*Id.*). In other words, Bush knew that Plaintiffs would refuse to fund the SXTV acquisition if she revealed the reduction in SXTV's 2010 forecast. Bush therefore concealed the new forecast from Plaintiffs, and re-affirmed the inflated $6.1 million figure to induce the funding. (A2771, A2775-78).

Without any explanation, the lower court deemed Shan's email "unclear." (A13). Yet the email could not be any clearer—Bush's Chief Operating Officer

told her that, based on his discussions with SXTV, the SXTV projection needed to be reduced, and Bush refused to lower it because the she knew that would scare off Plaintiffs. Even if there were an alternative reading of this email (there is not), any such competing interpretation would "merely raise an issue of fact" for the jury to consider. *See, e.g.*, *Polycast Tech. Corp. v. Uniroyal, Inc.*, 792 F. Supp. 244, 258 (S.D.N.Y. 1992) (denying summary judgment where internal correspondence stated that projections were "too optimistic").

D. Plaintiffs Relied On The Projections

There is no serious dispute that Plaintiffs relied on the projections. Lynn Tilton insisted on having them before Plaintiffs would agree to the loans. (A2420; *see also* A2836, A2840-43; A3354-55). She even specified the precise format of the projections to ensure that the right information was provided. (A640-41). Tilton and her team scrutinized the numbers after receiving them, and then communed with Bush to confirm their understanding and ensure that Bush herself blessed the numbers. (*See, e.g.*, A2760-61/183-85; A1136; *see also* A3142-43; A3144; A2836, A2843; A3354-55). During these conversations, Bush assured Tilton that she had "worked through the projected numbers," she "believed in them," and that "the worst-case scenario was very unlikely but would be the worst case." (A2746/77-78; A2761/185-86). The projections were so important to Plaintiffs that they separately bargained for a representation and warranty in the

Credit Agreement that Bush had prepared them in "good faith." (A204, § 4.1(hh)). It was with this understanding that Plaintiffs finally proceeded with the financing. Absent Bush's assurances about the projections, there would have been no loan. (A616, ¶¶ 4-5); *Fidelity Bank, N.A. v. Avrutick*, 740 F. Supp. 222, 231 (S.D.N.Y. 1990) (affidavit asserting that party would not have invested in securities raised factual issue on justifiable reliance).

This evidence is plainly sufficient to show Plaintiffs' reliance. Yet the lower court ruled that Plaintiffs failed to prove reliance as a matter of law. (A14-15). The court based its ruling on Plaintiffs' decision not to immediately exercise the most drastic remedy available under the Credit Agreement—declaring an event of default—when, after the loans were made, they uncovered evidence that the projections were provided in bad faith. (A14). The court failed to explain how this post-loan conduct could somehow negate the overwhelming and unrebutted evidence of Plaintiffs' reliance on the projections in making the loans. Presumably the court meant to imply that Plaintiffs would have immediately declared an event of default if they truly cared about the projections. Yet a jury could, and likely would, reach the opposite conclusion.

When Bush slashed the projections after receiving the final installment of the loan in March 2009, Plaintiffs' response was anything but indifferent. Chief Financial Officer Andrew Chang described Lynn Tilton's reaction as "the eruption

of Volcano Lynn" (A2022), and Plaintiffs insisted on the retention of financial advisors who would get to the bottom of XSEL's dubious financial reporting. (*See, e.g.*, A3009). Plaintiffs waited to exercise more drastic remedies under the Credit Agreement not because of any apathy toward the projections, but because those remedies would have pushed XSEL into bankruptcy and risked Plaintiffs' entire $57 million investment—as the lower court itself recognized. (A14-15). Indeed, when XSEL ultimately liquidated, Plaintiffs recovered a mere $241,000 in the liquidation proceedings. So, instead of proceeding immediately to liquidation, Plaintiffs first tried to salvage their investment by attempting to help revive the company. This strategy succeeded in part when, in July 2010, Plaintiffs negotiated a net $8.7 million repayment of the loans. (A1917). But Plaintiffs never received the $49 million in principal that remained owing.

Plaintiffs indisputably relied on the projections, and that reliance is not somehow nullified by their decision not to immediately seek a quixotic contractual remedy. At a bare minimum, whether Plaintiffs justifiably relied is a question of fact for the jury to decide.[7] *See, e.g., Brunetti*, 11 A.D.3d at 281 (reversing

[7] The lower court suggested that Plaintiffs' sophistication undermines its ability to prove reliance. (A14 ("Zohar cannot establish justifiable reliance as a sophisticated investor . . . .")). Yet the Court of Appeals has held that whether sophisticated parties "were justified in relying on the warranties they received is a question to be resolved by the trier of fact." *DDJ Mgmt., LLC v. Rhone Grp. L.L.C.*, 15 N.Y.3d 147, 156 (2010); *accord, e.g., Primavera Familienstifung v. Askin*, 130 F. Supp. 2d 450, 500 (S.D.N.Y. 2001) ("[W]hile it is certainly relevant that the [plaintiffs] were sophisticated . . . it

summary judgment because "the issue[] of . . . reasonable reliance . . . [is] not subject to summary disposition" and "the motion court improperly resolved material issues of fact in favor of defendants").

II. There Are Disputed Issues Of Fact Concerning Bush's Misstatement Of XSEL's Control Over Its Businesses

The record is teeming with evidence that Bush also lied to Plaintiffs when she claimed that XSEL controlled its Chinese businesses. The lower court ignored this evidence, and held as a matter of law that (1) Bush never actually made this representation, and (2) if she did, the representation was true.[8] These were improper factual findings, and it was reversible error to grant summary judgment based on them.

A. Bush Represented That XSEL Controlled Its Businesses

Bush represented both orally and in writing that XSEL controlled its Chinese businesses. She first made this statement in the 2007 20-F, on which Plaintiffs relied in making the loans. (A2857-58; A198-99, § 4.1(p)(ii)-(iii); A616, ¶ 6). There, Bush claimed in no uncertain terms that "we have effective control over our affiliated entities" in China. (A1091). Disregarding the plain meaning of these

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cannot be said as a matter of law that on this basis they cannot show justifiable reliance.").

[8] The lower court also found reliance lacking for the same reasons it concluded there was no reliance on the projections. (A16). As explained in Point I.D, that was reversible error.

words, the lower court held as a matter of law that Bush meant to say not that XSEL actually controlled the businesses, but merely that "XSEL had the necessary framework in place to exert control." (A16). In so ruling, the lower court ignored the testimony of XSEL's own witnesses, who confirmed that when Bush claimed XSEL had "effective control," she meant that it "had control over the businesses." (A1226/192; *see also, e.g.*, A1316-17/136-39). At the very least, the lower court improperly resolved material factual disputes by disregarding these admissions and adopting its own strained interpretation of the 20-F. *See, e.g., Bamira v. Greenberg*, 256 A.D.2d 237, 238-39 (1st Dep't 1998) (jury must choose between competing interpretations of a statement); *see also AGCO Corp. v. Northrop Grumman Space & Mission Sys. Corp.*, 61 A.D.3d 562, 563 (1st Dep't 2009) (same).

Moreover, Bush repeated the representation in conversations with Ms. Tilton, where she was "adamant that XSEL had complete control of both the operations and the finances of the businesses." (A616, ¶ 6; A2752/131-32; A2755/145-46; A2758/159-60). She assured Ms. Tilton "not once, but tens of times, that [XSEL] had access to all the cash at these operating entities . . . and that she had complete control over the operations, the employees, and the management teams." (A2758/159-60). The lower court simply ignored these conversations when it awarded summary judgment to Bush.

B. XSEL Lacked Control Of Its Businesses

Bush was well aware that her representations were false. As she conceded at the time, both XSEL's managerial deficiencies and its inability to pay earnouts prevented XSEL from exerting control over the businesses. The lower court erroneously disregarded this evidence, like it did for the rest of Plaintiffs' evidence.

1. Managerial Deficiencies Led To Ineffective Control

XSEL claimed to control most of its Chinese businesses through the nominee shareholding structure. (A1085-92). This structure was widely used by U.S. listed companies with operations in China. (A2901, A2928; A1299/87-88). Like XSEL, these companies reported in their public filings that they controlled their Chinese businesses through their nominee shareholders in China. But unlike its counterparts, XSEL never even tried to exert control over its businesses. Not only did Bush never discuss control with XSEL's nominee shareholders, she had no idea who they were. (A2663/332-35; A2681-82/405-07). Worse, XSEL's management did not even know what was happening at the business level. In September 2007, Chief Operating Officer Shan emailed Bush to advise her that "[w]e don't know when key employees of subsidiaries resign[] or [are] hired," and that XSEL management was not advised "until the last minute" when "a subsidiary opened or shut down a company." (A1333). Shan further advised that "[m]ore

than often we are informed of [the] signing of some very big contracts without knowing the terms, rather than being involved from the beginning." (A1333-34). In other words, far from controlling the businesses, XSEL was in the dark about major business decisions and had no say in the terms of major contracts.

The lower court disregarded Shan's email because it "was sent in September 2007, prior to the [Credit] Agreement." (A15). But that is exactly the point—Bush knew *before* entering the Credit Agreement that XSEL lacked control of the businesses, and she defrauded Plaintiffs by falsely claiming the opposite was true. The lower court's weighing of this evidence was not only improper on a summary judgment motion, it was irrational. This evidence alone precludes summary judgment as to whether XSEL controlled its businesses. *See, e.g.*, *Asabor*, 102 A.D.3d at 529 ("It is the province of a jury to weigh the evidence . . . .").

And there is much more. After conducting a detailed examination of the company, both Alixpartners and Houlihan confirmed that XSEL lacked managerial control of its businesses. Alixpartners found that XSEL had "[p]roblems with control over a multitude of subsidiaries" and "*never* exercised [its] rights" to obtain control over certain of the businesses. (A2934; A3185 (emphasis added)). For one business that XSEL had not attempted to control prior to Alix's engagement, XSEL obtained control "relatively quickly" as a result of the straightforward

measures that Alix took. (A3076-77/215-16). The lower court ignored this evidence too.

Houlihan likewise found that the Chinese operators of the businesses were in "de facto control" because of XSEL's "lack of effective managerial control systems." (A781). Bush "approved" this conclusion, and no one at XSEL disagreed. (*See, e.g.*, A769-72, A781; A853-56, A868; A1343-46, A1355; A1428-29; A1430-31; A1432-35, A1442; A1570-74, A1583; A1718-20; A2636/226-27, A2638/232-33, A2646/266-67; A1316/136-37). The lower court held that because Houlihan reached this conclusion in 2010, it sheds no light on whether XSEL also lacked control in 2008, when Bush made the representations to Plaintiffs. (A15-16). Presumably the court meant to imply that XSEL's control of its businesses may have weakened between 2008, when Bush represented that XSEL had control, and 2010, when Houlihan reached the opposite conclusion and Bush agreed with Houlihan. But the lower court ignored the testimony of general counsel McLean, who confirmed that XSEL's control of its businesses did *not* weaken during this same period. (A1311/104-05). According to McLean, if anything, XSEL's deficient controls *improved* between 2008 and when Houlihan declared their inadequacy in 2010. (*Id.*). The only logical inference is that XSEL's control was also deficient in 2008.

Each of these facts on its own creates a disputed issue regarding whether XSEL controlled its business. Together, they leave no doubt that the lower court erred in awarding summary judgment to Bush.

2. Delayed Earnout Payments Led To Ineffective Control

Even if that were not enough to defeat summary judgment, Plaintiffs proved that XSEL lacked control for another reason entirely—the nonpayment of its earnout obligations. Some of these earnout payments were owed to the Chinese nationals who managed XSEL's businesses. Bush conceded that "[w]hen XSEL was not able to make its earnout payments, the relationship between the parent and the subsidiaries was very difficult" (A2649/278-79), and Houlihan confirmed that the unpaid earnouts led to "ineffective control" of the businesses. (A868). Bush was aware that XSEL lost control of these businesses no later than early 2008. (*See, e.g.*, A2933 (Bush stating in April 2008 that "[r]umors are now rampant at X[SEL] that we are not good for the earnouts"); A1341 (business owner complaining about missed earnout payment in August 2008 and stating "I don't have any idea about the actual earnout payment status")). Bush therefore knew long before the Credit Agreement that XSEL lacked control of the businesses to whom XSEL owed the earnout payments. The lower court simply ignored that evidence, providing yet another independent basis for reversal.

III. There Are Disputed Issues Of Fact Concerning Bush's Misstatement Of XSEL's Historical Financial Information

The lower court failed to even address Bush's falsification of the earnings reported in XSEL's 2007 20-F. Yet the evidence shows that she knowingly misreported XSEL's finances and concealed a host of improper accounting practices.

Bush represented to Plaintiffs and XSEL's other investors that the 20-F did "not contain any untrue statement of a material fact" and "fairly present[ed] in all material respects" XSEL's "financial condition and results of operations." (A1128, A1130; A2857-63). Plaintiffs in turn relied on Bush's representations in agreeing to make the loans. (A617, ¶ 8; A2758-59/160-61; A198-99, § 4.1(p)(ii)-(iii); A361, § 4(a)).

Bush knew that, in fact, the 20-F was laced with material misstatements concerning XSEL's financial condition. XSEL's businesses booked unearned future earnings in current quarters in order to artificially boost their reported revenue. For example, Chief Operating Officer Shan advised Bush in November 2007, before the 20-F was issued, that "[t]he following explains the weaker Q4 [2007] . . . . Quite a lot of biz units moved their revenue to Q3 to drive up Q3 number." (A1218-19; *see also* A1221). Rather than correct the problem, Bush reported the inflated quarterly earnings and concealed the illicit revenue-shifting from Plaintiffs and other investors. (*See, e.g.*, A1243-44/595-96; A1251).

And that was just the tip of the iceberg. XSEL records produced in discovery also reveal "fake expenses," revenues that "were not recorded in the books and were used to pay kick-backs," account balances that "could not be reconciled with each other," and other "improper management of account books and records." (A1271; A1290; A2872; A2122-23; A2133). Put simply, "areas of controlling and reporting [were] nonexistent," and "nobody kn[ew] . . . where [the numbers] c[a]me from" at XSEL. (A3010; A3013-15/548-55). Bush herself conceded internally that because of XSEL's deficient financial oversight, it never "reach[ed] the standards required by U.S. security authorities." (A898; A915; A2646-47/267-68; A1718-20). Yet Bush falsely certified the accuracy of XSEL's financial statements to the SEC. (A1128, A1130).

XSEL's 2007 20-F in no way "fairly presented" the company's finances, and Bush knew it. Plaintiffs are entitled to present this claim to the jury.

IV. There Are Disputed Issues Of Fact Concerning Bush's Misstatement Of Economic Observer's Tax Obligations

Finally, Bush knowingly misstated Economic Observer's tax liabilities to induce Amendment 1 and the Consent. In November 2008, XSEL was notified by the Tax Administration that Economic Observer's "whole income from advertising business in 2007 [was] not entitled" to an enterprise income tax exemption. (A1837-42). The Tax Administration ordered Economic Observer to "make a full additional payment" of the back taxes owed. (A1839; *see also* A1842). This was

no small matter; Economic Observer concluded that this assessment would "damage[]" its "operation . . . so seriously that we may encounter the danger of bankruptcy." (A1844; A1848). Bush not only knew about the assessment, but she personally approved hiring a tax consultant to address it. (A1810). Despite this knowledge, Bush misrepresented to Plaintiffs that Economic Observer had "no material claims pending" for "past Taxes" and was "granted exemptions from enterprise income tax for . . . 2007." (A198-99, A203, §§ 4.1(p)(ii), (dd)(ii); A361, § 4(a); A2539, § 10; A1804).

The lower court erroneously held that "the record is . . . devoid of a finding by any taxing authority that there were past taxes due." (A17). That is simply false. Plaintiffs not only proffered letters from the Chinese Tax Administration ordering Economic Observer to "make a full additional payment" of the back taxes (A1837-42),[9] but the lower court cited these letters in its opinion (A17). When ruling on the Economic Observer claim, however, the lower court refused to acknowledge their existence.

V. The Case Should Be Reassigned On Remand

On remand, this Court should assign this matter to a different justice, as the trial court's flagrant disregard for the summary judgment standard demonstrates

[9] As noted above, Economic Observer operated in China under the monikers "Jingshi Jingguan" and "Beijing Jingguan Xingcheng Advertising." (A1068; A1079). The letters from the Tax Administration are therefore addressed to those entities.

his partiality against Plaintiffs. A judge is required "to perform judicial duties without bias or prejudice against or in favor of any person," and must not preside over any proceeding "in which the judge's impartiality might be questioned." 22 N.Y.C.R.R. § 100.3(B)(4), (E)(1). As explained above, the trial court flouted virtually every single rule of summary judgment, improperly ignoring or discounting Plaintiffs' evidence of fraud, making every inference in Bush's favor, and making credibility assessments which all favored Bush. This grievous disregard for the summary judgment standard reveals a transparent effort to rule for Bush, regardless of the merits of her motion.

Indeed, the lower court made it clear from the outset of this case that it had no intention of conducting a trial. At the very first hearing, before discovery had commenced, the court *sua sponte* invited Bush to move for summary judgment "any time you want to," and specifically "before depositions" were taken. (A2013-14). Even Bush acknowledged the impropriety of the court's suggestion by waiting until the completion of discovery—including 14 depositions—to file her summary judgment motion. But, true to its word, the lower court completely ignored the depositions in awarding summary judgment to Bush. Not one of them is cited in the court's summary judgment opinion, which at no point even tries to explain how summary judgment could be appropriate in light of the inculpatory testimony of XSEL's witnesses, including Bush herself. The lower court did not

want depositions in this case, and in granting summary judgment, it pretended they never happened.

Neither the parties nor this Court can have any confidence that the trial court will impartially adjudicate any further proceedings, and therefore, this Court should reassign this matter to a different justice upon remand. In fact, this Court has previously held on multiple occasions that reassignment of a matter after appeal was necessary because of this very justice's improper resolution of factual disputes at summary judgment. *Nausch v. AON Corp.*, 2 A.D.3d 101, 103 (1st Dep't 2003); *Baseball Office of Comm'r v. Marsh & McLennan, Inc.*, 295 A.D.2d 73, 83 (1st Dep't 2002); *Genton v. Arpeggio Rest., Inc.*, 232 A.D.2d 274, 274 (1st Dep't 1996); *see also R&R Capital LLC v. Merritt*, 78 A.D.3d 533, 534 (1st Dep't 2010) (assigning case away from Justice Ramos due to appearance of partiality); *Fresh Del Monte Produce N.V. v. Eastbrook Caribe A.V.V.*, 40 A.D.3d 415, 421 (1st Dep't 2007) (same). In *Baseball Office*, this Court reassigned the case to a different justice on remand in part because the trial court had improperly discredited the plaintiff's testimony and refused to draw reasonable inferences in the non-movant's favor. 295 A.D.2d at 81, 83. Similarly, in *Genton*, this Court remanded the case to a different justice where the trial court's dismissal of the plaintiff's allegation "as a matter of law was improper, since the issues raised by the parties' conflicting affidavits turn[ed] on the relative credibility of their

assertions." 232 A.D.2d at 274-75. The trial court's conduct below mirrors its conduct in *Genton* and *Baseball Office*, and similarly warrants reassignment of this matter upon remand.

CONCLUSION

For the foregoing reasons, this Court should reverse the Supreme Court's order granting Bush's motion for summary judgment.

Dated: August 18, 2015

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SUPREME COURT OF THE STATE OF NEW YORK
APPELLATE DIVISION, FIRST DEPARTMENT

ZOHAR CDO 2003-1 LIMITED and ZOHAR II 2005-1 LIMITED,

Plaintiffs,

vs.

XINHUA SPORTS & ENTERTAINMENT LIMITED, LORETTA FREDY BUSH, and ANDREW CHANG,

Defendants.

Index No. 651473/2011

PRE-ARGUMENT STATEMENT OF PLAINTIFFS-APPELLANTS ZOHAR CDO 2003-1 LIMITED AND ZOHAR II 2005-1 LIMITED

1. The title of this action is *Zohar CDO 2003-1 Limited and Zohar II 2005-1 Limited v. Xinhua Sports & Entertainment Limited, Loretta Fredy Bush, and Andrew Chang*, No. 651473/2011.

2. This action was commenced on May 27, 2011. The original parties to this action were Plaintiffs-Appellants Zohar CDO 2003-1 Limited and Zohar II 2005-1 Limited ("Plaintiffs-Appellants") and Defendants Xinhua Sports & Entertainment Limited ("XSEL"), Loretta Fredy Bush ("Bush"), Andrew Chang ("Chang"), and John McLean ("McLean"). The parties have changed as follows: Defendant McLean was dismissed from this action by an order entered March 22, 2012.

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4. This appeal is taken from a decision and order of the Honorable Charles E. Ramos, Supreme Court of the State of New York, County of New York.

5. In the Second Amended Complaint, Plaintiffs-Appellants allege that XSEL, Bush, and Chang fraudulently induced Plaintiffs-Appellants to loan $57.8 million to XSEL pursuant to an October 21, 2008 Credit Agreement and a February 20, 2009 Amendment thereto and fraudulently induced Plaintiffs-Appellants to consent to the sale of one of XSEL's businesses. Plaintiffs-Appellants assert claims for fraudulent inducement against XSEL, Bush, and Chang.

6. In a Decision and Order entered on January 15, 2015, the Supreme Court of the State of New York, County of New York (Ramos, J.) granted Bush's motion for summary judgment dismissing the Second Amended Complaint.

7. The Supreme Court erred in granting Bush's motion to for summary judgment. Among other things, the Supreme Court applied the wrong legal standard for deciding a

summary judgment motion, and incorrectly concluded that there were no material issues of disputed fact requiring a trial of this action.

Dated: New York, New York
January 22, 2015

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