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.

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

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INTRODUCTION

Bush's opposition is based on a fundamental misunderstanding of summary judgment. Like the lower court, she neither acknowledges her evidentiary burden nor tries to show that she has met it. She repeatedly ignores dispositive facts. For the evidence she does address, Bush repeatedly draws inferences in her own favor. She tries to legitimize this fact-finding exercise by repeated citation to a four-decade old contract reformation case. She claims this case compels summary judgment unless the evidence "unequivocally" establishes liability. On this faulty premise, Bush recites her own skewed version of the facts, and claims it is "equivocal" and entitles her to dismissal.

That is not how summary judgment works. It is hornbook law that in all cases, including fraud cases, the movant must meet its burden to show the absence of material factual disputes, and only then does the burden shift to the non-movant. Moreover, all reasonable inferences must be drawn in the non-movant's favor. This case does not remotely satisfy that standard.

The inculpatory evidence is overwhelming in this case. It is undisputed that Bush gave rosy projections to Plaintiffs while in possession of bleak internal ones. Nor does Bush dispute that she repeatedly told Plaintiffs XSEL "effectively controlled" its businesses while privately admitting it had "ineffective control." And it is undisputed that she concealed XSEL's revenue-shifting from investors

and that "areas of [financial] controlling and reporting [were] nonexistent" at XSEL.

The jury can, should and most likely would find Bush liable for defrauding Plaintiffs. This Court should apply the proper standard, and reverse the summary judgment award.

ARGUMENT

I. Bush Flouts The Summary Judgment Standard

It is well settled that in a fraud case—as in any other case—"[s]ummary judgment is a drastic remedy which should not be granted where there is any doubt of the existence of a triable issue or where the issue is even arguable." *Gale v. Kessler*, 93 A.D.2d 744, 745-46 (1st Dep't 1983) (citation omitted); *accord Brunetti v. Musallam*, 11 A.D.3d 280, 280-81 (1st Dep't 2004); *Talansky v. Schulman*, 2 A.D.3d 355, 357 (1st Dep't 2003).

The movant in a fraud case—like any summary judgment movant—must "meet [its] prima facie burden of establishing [its] entitlement to judgment as a matter of law." *Silver v. Newman*, 121 A.D.3d 667, 668 (2d Dep't 2014); *accord Genger v. Arie Genger 1995 Life Ins. Trust*, 84 A.D.3d 471, 472 (1st Dep't 2011). Only then does the burden shift to the opponent. *See J.A.O. Acquisition Corp. v. Stavitsky*, 18 A.D.3d 389, 390 (1st Dep't 2005). "[T]he opponent [of summary judgment in a fraud case] is entitled to the benefit of every favorable inference that

may be drawn from the pleadings, affidavits, and competing contentions of the parties." *Marshall v. Vilar*, 303 A.D.2d 466, 466 (2d Dep't 2003); *accord Millerton Agway Co-op., Inc. v. Briarcliff Farms, Inc.*, 17 N.Y.2d 57, 61, 63-64 (1966).

All of this should go without saying. Here, it does not. Bush refuses to acknowledge that she bears any evidentiary burden as the movant. (Bush Br. at 16-18). Nowhere does she recognize that Plaintiffs are entitled to "every favorable inference that may be drawn" from the evidence. *Marshall*, 303 A.D.2d at 466. She claims the standard is different in a fraud case (at 17-18), but ignores the controlling authorities holding otherwise—including those she herself cites. *Grullon v. City of New York*, 297 A.D.2d 261, 263 (1st Dep't 2002) (defendant must "ma[k]e a prima facie showing" before burden "shift[s] to plaintiffs"); *accord Genger*, 84 A.D.3d at 472; *Brunetti*, 11 A.D.3d at 280-81; *Talansky*, 2 A.D.3d at 357; *Epstein v. Scally*, 99 A.D.2d 713, 714 (1st Dep't 1984); *Gale*, 93 A.D.2d at 744-45.

Bush's entire argument is premised on her misconception of the summary judgment standard. She contends that unless the evidence is "unequivocal," Plaintiffs have not shown fraud "clearly" or "convincingly" enough to avoid summary judgment. (*See, e.g.*, Bush Br. at 1, 17, 18, 25, 26, 32, 37). This Court has rejected that notion time and again. *See, e.g.*, *DeRossi v. Rubinstein*, 233

A.D.2d 220, 221 (1st Dep't 1996) (denying summary judgment because the evidence cited "tends to support the fraud claim at least as much as it defeats it, thus raising triable issues of fact"); *Le Papillon, Ltd. v. Sheratonn Italiana, S.P.A.*, 177 A.D.2d 251, 251 (1st Dep't 1991) (reversing grant of summary judgment because "the parties presented sharply conflicting versions of the facts" and the trial court "usurped the jury's function").

Bush repeatedly cites *George Backer Management Corp. v. Acme Quilting Co.*, 46 N.Y.2d 211 (1978), in support of her version of the summary judgment "standard." *George Backer* is a contract reformation case. It holds that to reform a contract, a party must "overcome the heavy presumption that a deliberately prepared and executed written instrument manifested the true intention of the parties." *Id.* at 219. This requires showing "in no uncertain terms, not only that mistake or fraud exists, but exactly what was really agreed upon between the parties." *Id*. The standard of proof is unusually stringent in reformation cases because of the "danger that a party, having agreed to a written contract that turns out to be disadvantageous, will falsely claim the existence of a different, oral contract." *Chimart Assocs. v. Paul*, 66 N.Y.2d 570, 573 (1986).[1]

This is not a contract reformation case. Plaintiffs need not prove the fraud "in no uncertain terms" to defeat summary judgment. Rather, "[t]he truth [in a

[1] Bush also relies on *Abrahami v. UPC Construction Co.*, 224 A.D.2d 231 (1st Dep't 1996)—a case addressing Plaintiffs' burden of proof at trial, not summary judgment.

fraud case] must be arrived at in the lawful and customary way, this is, by a trial where the witnesses can be examined and cross-examined." *Millerton*, 17 N.Y.2d at 64.

II. There Are Disputed Issues Of Fact Concerning Bush's Falsification Of The October 2008 "Worst Case" Projections

On August 21, 2008, Bush received an email from CFO Andrew Chang conceding that XSEL anticipated a $30-40 million "funding gap." (*See* Pl. Br. at 6-8, 30-32). Bush agreed with Chang that "potentially there would be a [funding] gap." (A2673/371). Yet she repeatedly assured Plaintiffs that XSEL would be cash-positive, even in the "worst case" scenario, to induce the 2008 Credit Agreement. (A649; A2488-90; A2746/77-78; A2761/185-86; A1136). XSEL then entered liquidation because, as Bush and Chang predicted, it lacked sufficient cash to meet its obligations. (*See*, *e.g.*, A2935-36; A780; A821; A1947-48). Bush's argument that this evidence somehow fails to raise a triable issue regarding scienter or causation is simply wrong. (Bush Br. at 21-30).[2]

A. Bush Knew The "Worse Case" Projections Were False

1. Chang's August 2008 Email Revealed The Funding Gap

Bush claims that Chang's August 21 email lacks probative value because, in her view, it does not describe how the funding gap was calculated. (Bush Br. at

[2] Plaintiffs did not realize the breadth of the fraud until discovery yielded a wealth of inculpatory evidence. Contrary to Bush's claim (at 21 n.8), the fact that this evidence was not cited in the Complaint does not somehow diminish its probative force.

24-25). Even if that were true, how Chang calculated the funding gap is beside the point. Regardless of *why* a funding gap was projected, Bush knew that it *was* projected, and she lied to Plaintiffs when she claimed there would not be one. Nothing further is needed for the jury to find scienter. *See, e.g.*, *CPC Int'l, Inc. v. McKesson Corp.*, 70 N.Y.2d 268, 274, 285-86 (1987) (fraud alleged where defendant gave "fictitious projections overstating . . . business prospects which they knew were at odds with the unfavorable projections"); *see also Bradbury v. PTN Publ'g Co.*, No. 93-cv-5521 (FB), 1998 WL 386485, at *7 (E.D.N.Y. July 8, 1998) (summary judgment denied where defendant "knew that his sales projections were inaccurate when made").

Moreover, Chang explained the nature of the funding gap in his email. He said that XSEL lacked sufficient cash to make $30-40 million of the earnout payments due by the first quarter of 2009. Unless XSEL obtained financing to "bridg[e]" this "funding gap," it would default on those earnout obligations. (A767). Chang therefore recommended that XSEL take "a bridging loan to settle [these] earnout payments" and cover the "[$] 30-40 m[illion] funding gap." (*Id.*). Bush admits that XSEL never obtained this loan. (A2673/372). Therefore, when she told Plaintiffs that XSEL "would still be able to make the earnout payments" even in the "worst case" scenario, she understood exactly why that claim was false. (A2671/365).

2. Bush Foresaw The Funding Gap

The jury could conclude from Chang's email alone that Bush defrauded Plaintiffs. In addition, however, Bush made two critical concessions at her deposition: that (1) she knew in 2008 that "potentially there would be a [funding] gap," and (2) she believed the cash deficit described in Chang's email was XSEL's actual "worst case scenario." (A2672/368; A2673/371).

Bush disregards the first admission and mischaracterizes the second. She claims to have "testified that she did not recall the [funding gap] email and that she was 'guess[ing]' regarding the various interpretations" of it. (Bush Br. at 25-26). That is neither relevant nor true.

Bush testified that she independently reached the conclusion that "potentially there *would* be a [funding] gap" at XSEL. (A2673/371 (emphasis added); *id.* ("My recollection is that we were all trying to figure out – if all things didn't come together the way that we thought they would . . . then potentially there would be a gap . . . ."). Whether or not she recalls Chang's email, Bush herself foresaw the funding gap in 2008.

Furthermore, Bush testified to her understanding of Chang's email: "[A]gain, I think he is looking at a worst case scenario looking at what if we are not able to move the other assets or divest of them." (A2672/368). That is no "guess"; Bush presented her *belief* that the funding gap Chang described was

XSEL's worst case scenario.[3] However Bush tries to spin this testimony, a jury could readily conclude that she knew from Chang's email, not to mention her own assessment, that the worst case scenario was substantially worse than what she told Plaintiffs. "[T]he interpretation of . . . deposition testimony" is a "question[] for the jury" to decide. *Chafoulias v. 240 E. 55th St. Tenants Corp.*, 141 A.D.2d 207, 211 (1st Dep't 1988).

3. The August 26, 2008 Forecast Is Irrelevant

Unable to defend her concealment of the funding gap, Bush points to another set of projections Chang circulated on August 26, 2008. She claims that because these projections were more favorable, they necessarily supplied a good faith basis for the rosy worst case scenario given to Plaintiffs. (Bush Br. at 26). But the August 26 projections are irrelevant.

Bush fails to mention that the email attaching the August 26 projections also attaches a separate cash flow statement projecting a $44.6 million cash deficit for 2009. (A1145). This cash flow statement, and not the projections Bush identifies, appears to have been the worst case scenario. In any event, Bush offers no evidence that she relied on the August 26 projections when presenting XSEL's "worst case" scenario to Plaintiffs. Nor does Bush dispute that the August 26 projections are not worst case projections. (A1140-41). Thus, they have no

[3] Bush testified that she was "guess[ing]" not about Chang's email, but about a set of "spreadsheets" XSEL later sent to Plaintiffs. (A2672/368).

bearing on whether Bush induced the loan in good faith using the October 2008 "worst case" scenario.

Bush further concedes that XSEL maintained separate versions of its projections—an optimistic forecast for investors, and a pessimistic one for internal use. (*See*, *e.g.*, A2084-85). In all likelihood, the August 26 forecast is higher than the others because it was not even XSEL's internal assessment, and instead was prepared as a rosy scenario for investors. It was not XSEL's true internal worst case assessment.

4. Bush Understood The "Worst Case" Projections

Bush suggests that to prove scienter, Plaintiffs must show she participated in preparing the October 2008 "worst case" projections, and that there is no evidence of her participation. (Bush Br. at 23-24). She is wrong on both counts. Bush repeatedly told plaintiffs "she had worked through" the worst case scenario, "swore up and down" that "she believed in [it]," and misrepresented that "the worst-case scenario was very unlikely but would be the worst-case scenario." (A2746/77-78; A2761/185-86). Regardless of who created the projections, Bush knew they were false when she used them to induce the loan, and is liable for that fraud.

In any event, Bush was directly involved in creating the projections. It is clear from her own emails that she reviewed them for content, scrutinized their

assumptions, and made substantive changes. (*See, e.g.*, A1134 ("The only thing that is not clear is the assumptions on divestments. Can you send that to me as soon as possible?"); A1132 ("Did you get the analysis done with the 40 million and the 80 million? Please send to me when you have it done . . .")). Indeed, Bush was involved in the "creation of financial forecasts" throughout her tenure as CEO (A1306-07/21-22, A1307-08/25-26), and she did not deviate from that practice with a critical $57.8 million loan at stake.

B. Plaintiffs Relied On The "Worst Case" Projections

Plaintiffs demonstrated in their opening brief that the lower court erroneously found that the evidence was insufficient to show Plaintiffs' reliance on the "worst case" scenario. (Pl. Br. at 36-39). Bush does not dispute, and thus concedes, that there is no basis to dismiss the claims on reliance grounds.

C. The Misstatements Caused Plaintiffs' Loss

Bush instead advances a ground for dismissal that even the lower court rejected—causation. To obtain summary judgment on causation, Bush must show the absence of "transaction causation" or "loss causation." *Laub v. Faessel*, 297 A.D.2d 28, 31 (1st Dep't 2002). Bush makes neither showing.

1. There Is A Triable Issue On Transaction Causation

A plaintiff demonstrates transaction causation by proving that "the subject loans would not have been advanced" without the fraud. *Sterling Nat'l Bank v.*

Ernst & Young LLP, 62 A.D.3d 584, 584 (1st Dep't 2009). Plaintiffs' opening brief explained in detail why they would not have extended the loan had they known XSEL had no hope of repaying it. (Pl. Br. at 36-39).

Bush ignores this explanation and the evidence supporting it. (Bush Br. at 27-30). She claims that "Plaintiffs never uttered a word of protest" when Bush suddenly slashed the projections after the final loan installment. (Bush Br. at 29). But, in fact, CFO Chang described Lynn Tilton's reaction as "the eruption of Volcano Lynn." (Pl. Br. at 37-38; A2022). Bush also wonders why Plaintiffs did not immediately "declare an Event of Default if they determined that XSEL's prior projections had not been prepared in 'good faith.'" (Bush Br. at 29). But as explained in Plaintiffs' opening brief, exercising this remedy would have pushed XSEL into bankruptcy and doomed their entire $57 million investment. (Pl. Br. at 38-39). Plaintiffs' decision to instead try to revive XSEL and recoup a portion of their investment reflected sound business judgment, not apathy toward the projections.

2. There Is A Triable Issue On Loss Causation

Plaintiffs demonstrate loss causation by showing that their damages "were a foreseeable consequence of any misrepresentation or material omission." *Amusement Indus., Inc. v. Stern*, 693 F. Supp. 2d 327, 352 (S.D.N.Y. 2010) (citation omitted). Bush argues that because XSEL maintained positive cash in the

first quarter of 2009, the funding gap did not contribute to Plaintiffs' loss. (Bush Br. at 27-28). But the funding gap ultimately destroyed XSEL; the fact that it did not immediately destroy XSEL does not defeat the fraud claim.

Chang confirmed in May 2009 that XSEL had managed to delay the funding gap only by withholding all of the earnout payments. (A2935). He explained that XSEL negotiated a "revised earnout payment structure" adjourning the payment deadlines to later in 2009 and 2010. (A2935-36). He conceded that "XSEL w[ould] run into [a] cash shortfall of US$13 m[illion] . . . when the revised earnout payment[s] [were] due." (A2936). And nonpayment of the earnouts contributed to XSEL's demise in other ways. XSEL lost control of some businesses—and lost others altogether—when it stopped making payments. (*See, e.g.*, A785-86; A868). A number of the business managers diverted revenues to themselves, instead of passing them on to XSEL, as *de facto* earnout compensation. (*See, e.g.*, A781, 785-86). This evidence is more than sufficient to raise a disputed issue of fact as to whether Plaintiffs' loss "fell within the risk concealed by [Bush's] fraudulent misrepresentations." *Lau v. Mezei*, No. 10-cv-4838 (KMW), 2012 WL 3553092, at *8, 10 (S.D.N.Y. Aug. 16, 2012).

III. There Are Disputed Issues of Fact Concerning Bush's Falsification Of The March 2009 Projections

Bush used the March 6, 2009 projections to fraudulently induce the March 10, 2009 financing under Amendment 1, knowing that they contradicted XSEL's

February 24, 2009 "Internal Numbers." (Pl. Br. at 8-9, 33-34). Contrary to Bush's claim (at 30-35), there is copious evidence from which a jury could conclude that she knew the projections were false and that Plaintiffs extended the financing in direct reliance on them.

A. Bush Knew The March 6 Projections Were Fraudulent

Bush's argument that more "context" is needed to show that she acted with scienter (Bush Br. at 30-31) is frivolous. The evidence shows that Bush personally vouched for the March 6 projections, knowing that XSEL's "Internal Numbers" were substantially lower. (*Compare* A2775-77, 2782 *with* A1147, 1157). Then, five days *after* receiving the loan, Bush suddenly revealed XSEL's bleak internal assessment. (A1721-22). At her deposition, Bush could not explain the enormous discrepancy between the "Internal Numbers" and the March 6 projections. She claimed that the "Internal Numbers" did not actually reflect XSEL's internal assessment (A2618-19/165-67)—a demonstrably false claim that Bush has since retracted. She also falsely testified that she lowered the projections after the loan in response to regulatory changes in China. (A2620/172-73; A2674-76/375-85). It is now undisputed that there were no such regulatory changes. (A1734).

Bush responds by (1) asserting that additional evidence is needed; (2) speculating that the "Internal Numbers" may have been a "draft"; and (3) mischaracterizing her deposition testimony. (Bush Br. at 31-32). Bush is wrong,

and her attempt to draw more favorable inferences from the evidence is improper on a summary judgment motion.

First, Bush does not explain how additional evidence could make it any clearer that she knew about the "Internal Numbers." She received an email from her CFO attaching them, testified that she recalled and understood them, and reviewed similarly bleak internal projections during the same time period. (*See, e.g.*, A2491-92).

Second, Bush offers nothing to support her speculation that the "Internal Numbers" were a draft. The word "draft" appears nowhere in the document, and she did not claim it was a draft at her deposition. The document is labeled "Internal Numbers" and was sent by XSEL's CFO to its CEO on February 24, 2009. The jury can and should draw the obvious inference—that these were XSEL's internal numbers as of that date.

Finally, Bush contends that at her deposition, "she testified that she did not remember [the 'Internal Numbers'], and could only speculate as to what these projections represented." (Bush Br. at 32). But she does not dispute that she reviewed and understood the "Internal Numbers" when she received them in 2009. Moreover, Bush actually testified that she remembered them and falsely claimed to know how they had been calculated: "*My recollection* is that we took an average of all the research reports and said this is what we would look like on average."

(A2619-20/169-70 (emphasis added)). She now admits that this explanation is unsupportable, and thus effectively concedes that the "Internal Numbers" were in fact XSEL's own internal numbers.

There is no serious dispute that Bush understood the projections given to Plaintiffs were substantially higher than XSEL's internal numbers. A jury could undoubtedly conclude that she did.

B. Plaintiffs Relied On The Fraudulent March 6 Projections

Bush argues that Plaintiffs did not rely on the March 6 projections because she claims that Plaintiffs (1) were obligated to loan the money before they received the projections; (2) never reviewed the projections; and (3) should have known the projections' 2008 figures were inconsistent with XSEL's actual results. That is a blatant mischaracterization of the record.

1. The Projections' Sole Purpose Was To Induce The Funding

Bush argues that Amendment 1 obligated Plaintiffs to extend the financing when the agreement was signed on February 20, 2009, regardless of whether she falsified projections used to induce the funding on March 10, 2009. (Bush Br. at 31-32). This argument is meritless, as Bush herself conceded below. Bush admitted that at the "March 6, 2009" closing Plaintiffs "had the right to declare an Event of Default" and refuse to fund the loan if XSEL's "projections had not been prepared in 'good faith.'" (Docket No. 300 at 10-11; *accord* A204, § 4.1(hh);

A361, § 4(a); A363, § 6(b)). Indeed, Amendment 1 expressly conditioned Plaintiffs' obligation to fund on the delivery of Fredy Bush's March 6 certification attesting to the accuracy of the projections. (*See* A355, § 1(f) (requiring a "pro forma cash flow . . . certified by a director of [XSEL]"); A363, § 6(b)(i) (Plaintiffs "shall have received all of the documents required under Section[] 1(f)" before funding)). Thus, far from foreclosing Plaintiffs' reliance on the March 6 projections, Amendment 1 obligated XSEL to provide them in good faith as a condition to receiving the loan.

2. Bush Ignores The Evidence Showing Reliance

Bush also claims that Plaintiffs "can point to no document showing that any employee of Plaintiffs or Patriarch ever even looked at the March 6 Projections." (Bush Br. at 33). Plaintiffs not only can point to such documents but did so repeatedly in their opening brief (at 8, 33). XSEL's lawyers sent the projections to Plaintiffs' counsel before the closing and requested that they "forward them to Fred [Shane, Plaintiffs' employee] for his sign-off." (A2836, 2843). After Shane had reviewed the projections, Plaintiffs' counsel informed XSEL that "[o]ur client has signed off" on them. (A3354). Plaintiffs therefore not only reviewed the projections, they did so at XSEL's urging.

3. Bush Represented That The Projections Were Current

Bush assured Plaintiffs before the loan that the March 6 projections were "true, correct and complete." (A2775-77, 2782). Yet she now claims that Plaintiffs should have inferred that the projections were stale and could not be relied upon, because they supposedly contained 2008 figures that were inconsistent with the actual financial results for 2008 that XSEL previously released. (Bush Br. at 33). That is simply false. The projections Plaintiffs reviewed are reprinted in the appendix at page A2843, and they present *no* financial information for 2008, let alone outdated information. (*See also* A3169-71/191-200).

XSEL asked Plaintiffs to rely on these projections, Bush personally vouched for them, and they appeared to be current. That provides ample basis for the jury to conclude that Plaintiffs reasonably relied on the projections. *See, e.g.*, *Swersky v. Dreyer & Traub*, 219 A.D.2d 321, 328 (1st Dep't 1996) ("A [misrepresented] fact may not be dismissed as immaterial unless it is so obviously unimportant . . . that reasonable minds could not differ on the question of [its] importance." (citation omitted)).

IV. There Are Disputed Issues of Fact Concerning Bush's Falsification Of The Acquisition Projections

Bush contends that (1) there was no "statement to or from Ms. Bush that the [acquisition-specific] numbers given to Plaintiffs were inaccurate or unreasonable"; and (2) "[i]n each instance, the email train ends with Ms. Bush's

question" about the projections, as opposed to an inculpatory statement. (Bush Br. at 36-37). That is a frivolous misconstruction of the record.

Bush told Plaintiffs in December 2008 that SXTV would yield $6.1 million EBITDA in 2010. Shan emailed Bush a month later to inform her that "[b]ased on discussion[s] with SXTV . . . *we need to do some adjustment[s] to the numbers*," including a reduction of 2010 EBITDA from $6.1 million to $1.5 million. (A1164 (emphasis added)). This was a "statement to . . . Ms. Bush" by her Chief Operating Officer that "the numbers given to Plaintiffs were inaccurate." (Bush Br. at 36). And Bush ends the email chain not with a question, but with a statement of her own: that Plaintiffs "will never accept that 2010 goes from 6.1 to 1.5." (A1164). Knowing that Plaintiffs would refuse to fund the SXTV acquisition if she lowered the projections, Bush re-affirmed the inflated $6.1 million figure to induce the funding in March 2009. (A2771, A2775-78).

Similarly, when ASN sent Bush its projections, she rejected them and sought higher ones. (A1169, A1171-72; A2095-114; A3468, ¶¶ 220-21). ASN obliged, but warned that "[t]his is not the budget we agreed to." (A1203). Bush ignored that warning and emailed the inflated ASN budget to CFO Andrew Chang. This email chain ended not with a question, but with an instruction: "Andrew, this is what you should give Patriarch." (*Id.*).

The inflated projections contributed to Plaintiffs' losses in two foreseeable ways: (1) the acquired businesses' negative earnings made it harder for XSEL to repay Plaintiffs' loan; and (2) because the acquisitions were valueless, they contributed nothing to Plaintiffs' recovery at the liquidation. For example, XSEL's liquidator valued XSEL's interest in ASN "at zero," and the "shares [of ASN] held by XSEL [were] transferred" back to the prior owners "for no consideration." (A3492, ¶ 322). Plaintiffs therefore recovered nothing from ASN in the liquidation. The SXTV investment was even more detrimental, losing at least $47 million during its lifetime. (A804; A873). This not only impeded the loan repayments, but in 2010 XSEL diverted to SXTV $2.6 million that had been set aside to repay Plaintiffs. (A2699/475-76).

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

Bush also induced the Credit Agreement by falsely assuring Plaintiffs that XSEL controlled its businesses. (Pl. Br. at 10-14, 39-44). She now refuses to acknowledge that she made the representation or that it was false.

A. Bush Represented That XSEL Controlled Its Businesses

1. The Representation Is In The 20-F

Like the lower court, Bush claims she represented in the 2007 20-F only that "XSEL had the necessary framework in place to exert control," and not that XSEL actually controlled the businesses. (Bush Br. at 45-46 (quoting A16)). But

XSEL's witnesses confirmed that when Bush represented that XSEL "effective[ly] control[led]" the businesses, she meant that XSEL "had control over the businesses." (A1091; A1226/192). The lower court simply ignored this dispositive testimony, and so does Bush. (Bush Br. at 41-45).

The 20-F directly contradicts Bush's position:

> With each contracting shareholder, our subsidiary entered into four agreements relating to each shareholder's interest in the affiliated entity. The contracting shareholders have effective control over our affiliated entities as a result of their shareholding. *Consequently, we have effective control over our affiliated entities*.

(A1091 (emphasis added)). That language does more than confirm that the contractual relationships were in place. It represents that as a "consequen[ce]" of those relationships, XSEL "ha[d] effective control over" the businesses.

Bush herself offers additional support for this conclusion. She recognizes that, under FASB standards, XSEL was unable to consolidate the businesses' financial results unless XSEL controlled the businesses. (Bush Br. at 42 n.16). The 2007 20-F presents "consolidated results of operations" that include each of the business' financial results. (*See*, *e.g.*, Docket No. 320 at 75-79). When Bush certified the accuracy of these financial statements (A1128, A1130), she attested to the control XSEL allegedly asserted over the businesses.

2. Bush Made The Representation To Lynn Tilton

Bush also repeatedly represented to Lynn Tilton "that XSEL had complete control of both the operations and the finances of the businesses." (A616, ¶ 6; A2752/131-32; A2755/145; A2758/159-60). Bush claims that the Credit Agreement's boilerplate merger clause precludes Plaintiffs' reliance on those representations. (Bush Br. at 51-53). That is not the law.

"[A] general merger clause . . . does not operate to bar parol evidence of fraud in the inducement." *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Wise Metals Grp., LLC*, 19 A.D.3d 273, 275 (1st Dep't 2005). Such evidence is disallowed only if "the [merger] clause[] refer[s] to the particular subject matter as to which the representations are alleged with sufficient specificity to put the buyer on notice as to the clause['s] intended effect." *Culinary Connection Holdings v. Culinary Connection of Great Neck*, 1 A.D.3d 558, 559 (2d Dep't 2003). If the clause is "bare-bones, and . . . makes no reference to the 'particular misrepresentations' allegedly made," the fraudulent inducement claim may proceed. *LibertyPointe Bank v. 75 E. 125 St., LLC*, 95 A.D.3d 706, 706 (1st Dep't 2012).

The Credit Agreement contains only a "bare-bones" merger clause:

> This Agreement, the other Credit Documents and the Deposit Agreement contain and constitute the entire agreement of the parties with respect to the subject matter hereof and supersede all prior

> negotiations, agreements and understandings, whether written or oral, of the parties hereto.

(A253, § 11.6). This clause does not "refer to the particular subject matter" of any representations, let alone Bush's representations concerning effective control. *Culinary Connection*, 1 A.D.3d at 559; *LibertyPointe Bank*, 95 A.D.3d at 706. Plaintiffs were clearly entitled to rely on those representations.[4]

B. Bush Knew That XSEL Lacked Control Of The Businesses

Bush denies her representations were false, but cites no evidence that XSEL controlled its businesses in 2008 and 2009.[5] And she ignores or misconstrues the substantial evidence demonstrating her knowledge that XSEL lacked control.

As explained in the opening brief (at 10, 41) XSEL—like most public companies operating in China—relied on nominee shareholders to control its businesses. But XSEL never asked its nominee shareholders to assert control, which is one of several reasons why the Chinese operators were in "de facto control." (A3477-79, ¶¶ 254-63; A781). Bush testified that she recalled not one conversation that she or anyone else had with the nominees regarding control.

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[4] Bush misplaces her reliance on *Kremer v. Sinopia LLC*, 104 A.D.3d 479 (1st Dep't 2013) and *Perrotti v. Becker, Glynn, Melamed & Muffly LLP*, 82 A.D.3d 495 (1st Dep't 2011). (Bush Br. at 52). In *Kremer*, unlike here, the merger clause specifically barred reliance on the subject matter of the alleged misrepresentation. 104 A.D.3d at 480 (plaintiff's reliance "on a pre-contractual representation by [defendant] is refuted by the merger/integration clause"). *Perrotti* does not even involve a merger clause, let alone hold that a general one precludes a fraudulent inducement claim.

[5] Bush cites three pages of deposition testimony where she claims to have implemented procedures designed to strengthen XSEL's control. (Bush Br. at 47-48 (citing A2657-58/311-13)). She did not testify that these measures succeeded.

(A2663/332-33). Bush now ignores this concession. She also admitted that only one of the 18 nominee shareholders was even familiar to her. (A2663/333-35; A2681-82/405-07; A1091-92, A1801-02). She now blames her inability to identify the nominees on her faulty memory (Bush Br. at 48 n.17), but the jury is entitled to reject this excuse and infer that XSEL never even tried to assert control of the businesses. *See, e.g.*, *In re McMahan & Co.*, 230 A.D.2d 1, 5 (1st Dep't 1997) ("[T]he trier of fact must decide which witnesses to believe, what portion of their testimony is to be accepted and what weight is to be ascribed thereto.").

Nor does Bush adequately address the internal XSEL correspondence demonstrating its lack of control. COO Shan emailed her in September 2007 admitting that "[w]e don't know when key employees of subsidiaries resigned or [were] hired," "we don't know if a subsidiary opened or shut down a company," and "we are informed of the signing of some very big contracts without knowing the terms." (A1333-34). Bush argues that Shan's email covered other topics as well (Bush Br. at 47), but that does not somehow negate his admission that XSEL was unaware of what its businesses were doing.

Bush also contends that "Plaintiffs offered no evidence whatever that the concerns Zhu Shan noted continued in 2008." (*Id.*). Not only is that untrue, the evidence shows that the situation worsened in 2008. It was then that XSEL began defaulting on its earnout payments. (*See, e.g.*, A2933; A1341). Bush admitted at

her deposition that this resulted in a lack of control. (A2649/278-79 ("When XSEL was not able to make its earnout payments, the relationship between the parent and the subsidiaries was very difficult . . . ")). These difficulties began "very quickly in 2008" (A1235/457-59) and continued into 2009 and beyond. (*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 September 2008); A1342 (Bush stating in November 2008 that for two businesses, "there is no money for their earnout"); A1337 (business owner stating in December 2008 that additional measures were needed to "mak[e] ownership of X[SEL] on various local operations legitimate"); A2142 (business owner stating in March 2009 that the "earn out" payment was "already far overdue"); A2087 (business owner stating to Bush in March 2009 that "[t]here were so m[any] grievances spreading within the operation since you indicated that Xin Hua would not be able to make [the earnout] payment")).[6] Bush ignores the evidence uncovered by Alixpartners that XSEL "*never* exercised [its] rights" to control the businesses. (A3185) (emphasis added).

These conclusions were confirmed by Houlihan Lokey in 2010. Bush does not dispute that she "approved" Houlihan's conclusion that XSEL had "ineffective

[6] Bush disregards most of this evidence. She misrepresents to the Court that Plaintiffs rely on only "two emails" and baldly claims that nonpayment of the earnouts was a "short-term" issue. (Bush Br. at 50-51). Bush simply ignores the evidence that this was a continuous problem that XSEL never resolved.

control."[7] (*See* Pl. Br. at 43). She also ignores general counsel McLean's testimony that Houlihan's findings contradicted her public assurances that XSEL controlled its business. (A1316-17/136-39). Bush instead claims that the "lack of effective managerial control systems" Houlihan identified arose for the first time in May 2010, when Houlihan issued its report. (Bush Br. at 49). Yet XSEL's management team was unchanged between 2008 and 2010, and Bush offers no reason to think that their management skills worsened. General counsel McLean confirmed they did not, testifying that XSEL's controls remained "fundamentally the same" during this time period. (A1311/103-05).

The unrebutted evidence overwhelming shows that XSEL lacked control of its businesses. Bush not only knew this, she admitted it at the time. She now claims otherwise but offers no evidence to support her claim.

C. The "Risk Disclosures" Concealed The Relevant Risks

Bush makes much of the fact that XSEL controlled its Chinese businesses through nominee contracts, instead of direct ownership. (Bush Br. at 41-45). That is beside the point. Regardless of how XSEL controlled its businesses, Bush reassured Plaintiffs that XSEL did control them. When she made these representations, Bush knew that XSEL did not control the businesses.

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[7] Bush mischaracterizes the testimony of Houlihan's witness (Bush Br. at 49 n.18), who acknowledged that the problems described in Houlihan's report "may have been" an issue "from the very beginning of the company." (A1907/378-79).

Bush's reliance on XSEL's risk disclosures is similarly unavailing. (Bush Br. at 42-44). In the 20-F, Bush represented that "we have effective control over our affiliated entities," but warned that the nominee shareholders "may breach" their contracts with XSEL, thereby jeopardizing control. (*Id*. at 43). When Bush made this statement in May 2008, she knew that XSEL already lacked control of the businesses. *See, e.g.*, *Basis Yield Alpha Fund (Master) v. Goldman Sachs Grp., Inc.*, 115 A.D.3d 128, 138 (1st Dep't 2014) (risk disclosure inadequate where the "events . . . had already occurred").

Moreover, XSEL lacked control not because the nominees breached the contracts, but because XSEL made no effort to enforce them. Bush and XSEL's other witnesses admitted that the contracts were never breached and the risks identified in the 20-F never materialized. (*See, e.g.*, A2655/301-02; A1314/122-23, A1315/126-28.) To the contrary, the nominees were eager to help and did so when XSEL's outside consultants finally asked them in 2010. (A3478-79, ¶¶ 260-63). Thus, the risk disclosures concealed the real problem—that XSEL's mismanagement, not any contractual breach, had already deprived XSEL of the control it claimed to have. *See, e.g.*, *Loreley Fin. (Jersey) No. 3 Ltd. v. Citigroup Global Mkts. Inc.*, 119 A.D.3d 136, 144 (1st Dep't 2014) (disclosures "f[e]ll well short of tracking the particular misrepresentations and omissions alleged").

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

Bush misrepresented that XSEL's 20-F "fairly present[ed]" XSEL's financial condition, knowing that the businesses engaged in illicit revenue shifting. (*See* Pl. Br. at 45-46). Bush knew that "*[q]uite a lot of biz units* moved their revenue" from quarter to quarter "to drive up [the] number[s]." (*Id.* at 45; A1218) (emphasis added). However, she now argues, on the basis of a single example of a single company (Century Media) that distributed television programming earlier than expected, that what moved from quarter to quarter "was XSEL's subsidiaries' actual performance of contract work." (Bush Br. at 39 (citing A2303)). Bush is conspicuously silent about what all of the other businesses were doing, and she does not try to support her baseless contention that what may have been true for Century Media was necessarily true for XSEL's other affiliates.

More importantly, Bush's SEC filings concealed the revenue shifting from investors. Her filings blamed XSEL's fluctuating revenues on other reasons—such as an "increase in expenditures" and "administrative costs"—even though she knew that the revenue shifting was a culprit. (A1251; *compare with* A1218). Bush certainly never claimed in these filings that the early performance of contract work explained the fluctuations. (A1251).

Nor does Bush adequately address the litany of additional financial improprieties Plaintiffs identified. (*See* Pl. Br. at 46). She complains that certain

misconduct occurred at the businesses before XSEL acquired them, but neither addresses the subsequent misconduct nor claims that any of it was ever remedied. (Bush Br. at 40). She also ignores many of the improprieties Houlihan uncovered, including that "[a]reas of [financial] controlling and reporting [were] nonexistent" at XSEL. (A3013-15/548-55; *see also*, *e.g.*, A898 (recommending a "restructuring" of "financial reporting" so that "[a]ll financial reporting and accounting [c]ould reach the standards required by U.S. securities authorities"); A915; A3010).

When Bush certified the accuracy of XSEL's financial statements, she knew they were falsified many times over. Here again, summary judgment is wholly inappropriate.[8]

VII. There Are Disputed Issues of Fact Concerning Bush's Misstatement of Economic Observer's Tax Liabilities

Bush induced Amendment 1 and the Consent by misrepresenting that Economic Observer had no liability for unpaid taxes, when she knew the Chinese government had imposed a substantial assessment. (Pl. Br. at 46-47).

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[8] Amazingly, Bush denies that her criminal co-defendants looted XSEL—after failing to dispute it below—and misrepresents to the Court that the evidence is not part of the record. (Bush Br. at 15 n.7). It is, and Plaintiffs encourage this Court to review it. (*See, e.g.*, Docket Nos. 322, 325, 408-10). The Court will learn that Bush repeatedly and inexplicably had XSEL reimburse their lavish personal expenses. (A3492-93, ¶¶ 325-26). Plaintiffs excluded this evidence from the appendix only because of the appendix's size and Bush's failure to refute the evidence below. Moreover, Bush does not dispute that she maintained an illicit role for her criminal co-defendants in XSEL's financial reporting, which helps explain why it was fraudulent. (*Id.*).

In response, Bush denies making any misrepresentation, claiming there was "doubt" as to whether Economic Observer "actually owed any taxes." (Bush Br. at 55). That is false. The document Bush relies on (*id.*) itself makes clear that XSEL "agreed" that Economic Observer's "[u]npaid corporate income tax" liability was "real." (A3103). Moreover, Bush represented that none of XSEL's affiliates had any "material claims *pending, proposed, or threatened*" against it for "past Taxes." (A203, § 4.1(dd)(ii) (emphasis added); A361, § 4(a); A2539, § 10). When she made these representations, the Chinese government had already ordered Economic Observer to "make a full additional payment" of back taxes. (A1839; A1842). Bush's representation that there was no tax claim pending was thus completely false.

Bush next claims to have been unaware of the tax assessment. (Bush Br. at 56). But Chang confirmed that Bush approved hiring a tax consultant to address it. (A1810 ("I discussed with Fredy" the plan "to engage [the consultant] to help handling EO & EWEO income tax issue")). And XSEL admitted that the assessment would cause Economic Observer to "encounter the danger of bankruptcy." (A1844; A1848). The jury is entitled to reject Bush's dubious claim that a problem of this magnitude somehow escaped her attention. *McMahan*, 230 A.D.2d at 5.

Finally, Bush erroneously claims Plaintiffs suffered no injury when they entered the Consent. (Bush Br. at 56-58). She ignores, and thus concedes, that her misstatement fraudulently induced the $24.6 million Plaintiffs loaned under Amendment 1. (A203, § 4.1(dd)(ii); A361, § 4(a); A617-18, ¶¶ 10, 12). And the Consent caused Plaintiffs additional harm. It is undisputed that when Plaintiffs consented to the sale of Economic Observer for $24 million, they forfeited the right to 10% of the proceeds. (A2535, § 1(e); A2028). The harm they suffered is therefore evident—it is $2.4 million.

CONCLUSION

For the foregoing reasons, and those set forth in Plaintiffs' opening brief, this Court should reverse the Supreme Court's order granting Bush's motion for summary judgment, and reassign the case to a different justice.

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