

STATE OF INDIANA            )                   MARION SUPERIOR COURT  
                                      )ss:            CIVIL DIVISION 10  
COUNTY OF MARION        )                   CAUSE NO. 49D10-0606-CT-22460

NATIONAL WINE AND SPIRITS, INC., )  
et.al.,                                    )  
  )  
          Plaintiffs,                     )  
  )  
                          vs.                )  
  )  
ERNST & YOUNG LLP,                    )  
  )  
          Defendant.                     )

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**ORDER GRANTING DEFENDANT’S MOTION FOR SUMMARY JUDGMENT  
IN PART AND DENYING IN PART**

**Statement of Case**

Plaintiffs National Wine and Spirits, Inc. (“National”) and related entities seek damages for alleged fraud and deception from Defendant Ernst & Young, LLP (“Ernst”) allegedly occurring during a previous arbitration hearing. Ernst moves for summary judgment largely arguing this action is precluded by the res judicata effect of the previous arbitration award. The Court finds National’s claims are not precluded by res judicata, but summary judgment should be entered against National’s count of fraud.

**Issues**

Does the previous arbitration award preclude National’s present claims that fraud and deception occurred during the arbitration proceeding itself?

Does Ernst otherwise show it is entitled to judgment as a matter of law on National’s counts?

**Facts and Procedural History**

National and Ernst litigated a prior negligence action involving Ernst's past financial auditing engagement during 1998-2001. National sought damages, and the matter was ordered to arbitration pursuant to the parties' June 24, 1998 contract: "Any controversy or claim arising out of or relating to the services covered by this letter . . . shall be submitted . . . to binding arbitration . . ." The contract indicates services to "audit and report on the combined financial statements of" National, and to "determine that appropriate members of management are informed of fraud and illegal acts . . ."

During the term of this auditing engagement, a National employee's fraud and theft caused losses totaling around \$3.5 million or more. Ernst's audits allegedly failed to detect these actions and losses. The parties eventually entered arbitration, pursuant to the engagement contract, on National's claims of negligence, breach of contract, and unjust enrichment. Just ten days before the arbitration hearing began on May 24, 2004, Ernst produced documents related to increasing "aged accounts receivable" relevant to the audit. This disclosure took place 3 years after the disputed auditing work. The documents purported to show Ernst's "cell notes" - typed annotations made upon computer accounting records - to prove Ernst discovered some irregularities and communicated the information to National. The parties litigated the nature and validity of the cell notes during the proceeding.

On July 21, 2004, the arbitration award found negligence, damages, and comparative fault between the parties. It specifically held "National . . . negligently failed to utilize or even review its own account receivable aging reports which showed the dramatic increase in aged accounts and would have led to further investigation that would have exposed [the employee's] fraud and theft." Accordingly, Ernst was ordered to pay only 60% of the damages.

Although the award was paid by Ernst and accepted by National, neither side sought “confirmation” of the award in a court of law.

On June 1, 2006, National filed the present action for fraud and deception. National largely claims Ernst altered financial records after the engagement ended, and submitted the altered records, as well as false testimony, during the arbitration hearing itself.

Ernst moves for summary judgment arguing this action is precluded by the res judicata effect of the previous arbitration award, and National’s claims otherwise fail as a matter of law. Also, Ernst makes its own counterclaims for fraud and deception - against National - for National’s allegedly false testimony at the arbitration proceeding.

## **Law**

Summary judgment is proper if the evidence shows there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. T.R. 56 (C). The moving party must establish the “absence of any genuine issue of fact as to a determinative issue.” Jarboe v. Landmark Community Newspaper, Inc. (1994), Ind., 664 N.E.2d 118, 123. If there is sufficient evidence to establish the elements of a determinative defense, the burden shifts to the plaintiff to make sufficient showing to establish the existence of a genuine issue for trial regarding such defense. Shell Oil Co. v. Lovold Co. (1998), Ind., 705 N.E.2d 981. On a motion for summary judgment, all doubts as to the existence of material issues of fact must be resolved against the moving party. Owens Corning Fiberglass Corp. v. Cobb (2001), Ind., 754 N.E.2d 905, 909.

The intent of the parties is the longstanding hallmark of contract construction, including arbitration contracts. MPACT Construction Group LLC v. Superior Concrete Constructors, Inc. (1987), Ind., 802 N.E.2d 901, 905; First Federal Sav. Bank v. Key Markets, Inc. (1990), Ind.,

559 N.E.2d 600; Centennial Mortgage, Inc. v. Blumenfeld (2001), Ind.App., 745 N.E.2d 268, 273. More importantly, the parties' arbitration contract "controls" which issues are subject to arbitration. IBEW Local 1400 v. Citizens Gas & Coke (1981), Ind.App., 428 N.E.2d 1320, 1324.

A final arbitration award is *res judicata*, like a court judgment, barring relitigation of the issues determined during the arbitration proceeding. Brougher Agency, Inc. v. United Home Life Insurance Co. (1993), Ind. App., 622 N.E.2d 1013, 1016. *Res judicata* can be "claim preclusion" or "issue preclusion." Claim preclusion means a final judgment has been rendered and a subsequent action on the same claim between the same parties is barred. When claim preclusion applies, all matters that were or might have been litigated are deemed conclusively decided by the prior judgment. Claim preclusion applies when: (1) the former judgment was rendered by a court of competent jurisdiction; (2) the former judgment was rendered on the merits; (3) the matter now at issue was, or could have been, determined in the prior action; and (4) the controversy adjudicated in the former action was between the parties to the present suit or their privies. Dawson v. Estate of Ott (2003), Ind.App., 796 N.E.2d 1190, 1195.

Issue preclusion, or collateral estoppel, bars subsequent re-litigation of facts or issues that were necessarily adjudicated in a prior cause of action, even if the second action is on a different claim. It requires: 1) a final judgment on the merits in a court of competent jurisdiction; 2) identity of the issues; and 3) the party to be estopped was a party or the privy of a party in the prior action. In determining whether the "defensive" use of collateral estoppel is appropriate, the court must also consider whether the party against whom the judgment is plead had a full and fair opportunity to litigate the issue, and whether it would otherwise be unfair under the circumstances to permit the use of collateral estoppel. Small v. Centocor, Inc. (2000), Ind. App., 731 N.E.2d 22, 28.

An arbitration award must be “confirmed” by a separate court action to have any effect. I.C. 34-57-1-15; I.C. 34-57-2-12 *et seq.*; Shroyer v. Bash (1877), 57 Ind. 349; Anderson v. Anderson (1879), 65 Ind. 196. Some courts have found confirmation to be a prerequisite to standing. *See* MBNA Am. Bank, N.A. v. Rogers (2005), Ind.App., 835 N.E.2d 219. But Indiana law does not specifically resolve whether an *unconfirmed* arbitration award is res judicata over subsequent actions. Some jurisdictions do find such awards are res judicata, but the holdings still require a comparison and analysis of claims. *See e.g.* Stulberg v. Intermedics Orthopedics, Inc., 997 F.Supp. 1060 (N.D.Ill. 1998). Therefore, there may be no practical difference, for a court’s res judicata analysis, between confirmed or unconfirmed arbitration awards.

The elements of actual fraud are: (i) material misrepresentation of past or existing facts by the party to be charged (ii) which was false (iii) which was made with knowledge or reckless ignorance of the falseness (iv) **was relied upon by the complaining party** and (v) proximately caused the complaining party injury. Rice v. Strunk (1996), Ind., 670 N.E.2d 1280, 1289 (emphasis supplied). The reasonableness of a plaintiff’s “reliance” is usually a question of fact. Biberstine v. N.Y. Blower Co. (1993), Ind.App., 625 N.E.2d 1308, 1316. However, the reasonableness of reliance can in some circumstances be determined as a matter of law:

When confronted with representations which are “simply not the stuff that fraud is made of,” a court may find as a matter of law either that the representations are not actionable or that the plaintiff had no right to rely as a matter of law.

Plymale v. Upright (1981), Ind.App., 419 N.E.2d 756, 763.

The applicable elements for civil recovery for deception are taken from the criminal statute at I.C. 35-43-5-3 (2), that is, knowingly or intentionally making a false or misleading written statement with intent to obtain property. Black’s Law Dictionary (5<sup>th</sup> Ed.) defines

“property” as “. . . That which is peculiar or proper to any person; that which belongs exclusively to one . . . *Criminal code*. ‘Property’ means anything of value . . .”

Overall, judgments of courts, even for fraud upon courts, may be attacked in a variety of ways, including independent causes of action. Trial Rule 60(B); Stonger v. Sorrell (2002), Ind., 776 N.E.2d 353.

### **Analysis**

First, Ernst’s own counterclaims for fraud and deception may comprise an adequate record of disputed material fact here.

Second, Ernst fails to show it is entitled to judgment under res judicata. Nevertheless, judgment as a matter of law should be entered against National’s fraud claim for lack of “reliance.”

#### National’s Present Claims Are Not Precluded By Res Judicata

Since neither party “confirmed” the prior arbitration award, the Court may be obligated to find the award unenforceable or lacking effect. But to the extent the unconfirmed award may still be entitled to res judicata status, the Court is likely required to conduct its own res judicata analysis.

With respect to “claim preclusion,” the matters now at issue were not, nor could have been, decided in the prior arbitration proceeding. With respect to “issue preclusion,” there is no identity of issues between the prior arbitration and this action. The contract language shows the parties intended to arbitrate “[a]ny controversy or claim arising out of or relating to the services covered by this letter . . .” The only services clearly covered by the letter include “audit and report on the combined financial statements of” National, and to “determine that appropriate

members of management are informed of fraud and illegal acts . . .” The parties’ disputes about those services were arbitrated. The parties’ dispute about Ernst’s alleged actions during arbitration, from the present Complaint, are not indicated, and are not precluded by the prior arbitration.

As the arbitration award indicates, the parties’ longstanding battle has its basis in negligence, that is, the comparative fault of failing to detect significant embezzlement. The alleged fraud and deception of Ernst – originating in issue only 10 days before the arbitration proceeding began – is separate and distinct from the measure of comparative fault. The previous arbitration award included consideration of evidence regarding the credibility of the alleged cell notes, and a determination regarding the alleged comparative fault of National by failing to act. Although the presently claimed intentional dishonesty of Ernst may also constitute a breach of a duty (negligence), the overlaps in such evidence are not nearly enough to justify a conclusion that the issues are identical. The parties litigated alleged negligence before – but just because fraud and deception may also be negligence does not equate to identity of issues. National’s burden now demands proof of actions and intent since the auditing engagement was complete – a new and different negligence.

In addition, Ernst’s late disclosure of the disputed “cell notes” prevented a full and fair opportunity for either side to litigate the issue, and such circumstances preclude defensive collateral estoppel in this different action. The purported ‘cell notes’ allegedly form the basis of comparative fault in the arbitration award. Accordingly, disclosure and discovery of such cell notes only 10 days before arbitration begs the inevitable question: “Where have they been for three years?” National now accuses Ernst of falsifying the notes, and seeks to prove it in this action. It is not fair to hold National accountable for its attempt to arbitrate by applying res

judicata upon Ernst's late evidence, and no party should ever be forced to effectively waive subsequent claims under such constrained circumstances. The policy of res judicata may be akin to "one bite at the apple."<sup>1</sup> But this present action is now "oranges" – and National never got a full bite to begin with.

### National Does Not Show "Reliance" For Its Fraud Claim

The tort of fraud requires allegations and proof of a plaintiff's reliance upon misrepresentation. Fraud is meant to provide damages to someone who is fooled into something. National claims Ernst was false to a tribunal – not to National. Furthermore, the record shows National was not necessarily fooled - it litigated the veracity of the alleged misrepresentation. Its arguments about "reliance" are too speculative, misplaced, and "simply not the stuff fraud is made of." The record shows no dispute about the material facts on this claim, and no reliance. Therefore, there is no element of reliance, as a matter of law, upon the alleged misrepresentations of Ernst.

### **Conclusion**

Ernst fails to show that res judicata precludes National's present claims.

Ernst shows it is entitled to judgment as a matter of law upon National's fraud claim.

### **Order**

Ernst's Motion for Summary Judgment is granted with respect to the claim of fraud in

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<sup>1</sup> See e.g. Depeyster v. Town of Santa Claus (2000 ), Ind.App., 729 N.E.2d 183; Sumbry v. Misc. Docket Sheet (2004), Ind.App., 811 N.E.2d 457; Bosley v. State (2007), Ind.App., 871 N.E.2d 999.

National's Complaint. It is denied in all other respects.

Dated this 4<sup>th</sup> day of February 2008.

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David J. Dreyer, Judge