CARNEGIE INTERNATIONAL CORPORATION, et al	*	IN THE
Plaintiffs	*	CIRCUIT COURT
	*	FOR
vs.	*	BALTIMORE CITY
GRANT THORNTON, LLP, et al	*	
Defendants	*	CASE NO.: 24-C-00-002639

* *

MEMORANDUM

I. PROCEDURAL FACTS

On May 23, 2000, plaintiffs, Carnegie International Corporation ("Carnegie"), E. David Gable, and Lowell Farkas, brought this action against defendants, Grant Thornton, LLP, and Arthur E. Flach. All three plaintiffs allege the following claims against Grant Thornton: fraud and deceit; interference with business relations; fraudulent inducement; negligence/malpractice; and breach of contract. All three plaintiffs allege negligence/malpractice against Flach. Plaintiff Carnegie alleges breach of trust and excessive fees against both defendants. Plaintiffs Gable and Farkas allege defamation against both defendants.[1]

On motion of both defendants, this Court dismissed the following claims on October 2, 2001: (1) Gable's and Farkas' claims for fraud and deceit, interference with business relations, fraudulent inducement, and negligence/malpractice; (2) all claims for breach of contract; and (3) all plaintiffs' requests for punitive damages as to claims of fraudulent inducement, excessive fees, and negligence/malpractice.

A bench trial began on November 5, 2001. On November 8, 2001, plaintiff raised, in open court, a discovery issue relating to the non-production of certain audit work papers. This Court suspended trial and, following briefing, by order dated January 11, 2002, appointed Juliet

[1] Prior to trial Plaintiffs Gable and Farkas chose not to pursue the defamation claims.

A. Eurich, Esq. as a Special Master for purposes of investigating the circumstances related to the alleged non-production of these papers. The Special Master held an evidentiary hearing and filed a recommendation on August 12, 2002. On August 20, 2002, plaintiffs' filed exceptions to the Special Master's report and recommendation. Following further briefing, this Court by order dated February 14, 2003: (1) denied each of plaintiff's exceptions, except as to Findings of Fact Nos. 183 and 233; (2) accepted the Special Master's Report and Recommendations in all other respects; and (3) denied plaintiff's motion for default judgment and request for alternative sanctions.

The case resumed trial on or about March 3, 2003 and continued through April 4, 2003. Subsequently, testimony was presented by depositions. The Court has considered the deposition testimony of the following witnesses: Stuart Agranoff, Arthur Flach, Mort Goldman, Joseph Graziano, Gary Illiano, Stanley Krosin, Craig Miller, Hillel Moerman, Edward Nusbaum, Thomas Rafter, Edward Raskin, Steven Corso, Perry Peregoy, J.W. Starr, Lashra Caruthers, Scott Caruthers, Gary A Dahne, Andrew M. Hermann, Gerald Kirby, Fred Rudy, David Pearl, Donna Gable Ruff, E David Gable, Jr., Lowell Farkas, Perry Peregoy, Frank T. Simpson, David Stinson, James Sheldon Blair, Joseph Trammell, Fred Rudy, and Daniel Zardorozny.

Plaintiffs' and defendants' proposed findings of fact and conclusions of law were filed on June 13, 2003.

On or about July 1, 2004 the defendants filed a "Motion to Supplement the Record." It will be denied.

II. <u>FINDINGS OF FACT - BACKGROUND</u>

Carnegie is a Colorado corporation that maintains its corporate office in Maryland. Carnegie International Corporation came into existence, by that name on May 22, 1996 when A & W Corporation (A & W Corporation was previously known as Solenergy Corporation.) changed its name. A & W Corporation ("A & W") had been a shell corporation that was not engaged in any business activities.

On September 12, 1996, Gable was elected as Carnegie's Chief Executive Officer. On May 21, 1997, Gable was elected Chairman of Carnegie's board of directors. Carnegie hired Farkas as its President in May 1997. Farkas was also a member of Carnegie's board of directors from September 2, 1997. David Pearl became Carnegie's Secretary on September 12, 1996. Pearl served in that capacity until he resigned on January 21, 1999. Following his resignation, Pearl performed consulting services for Carnegie and maintained an office within Carnegie's offices.

Gable and Farkas shared dual responsibility for discharging the duties of a chief financial officer for Carnegie until September 1998. From September 1998 until February 1999, Richard Greene, a certified public accountant, served as Carnegie's chief financial officer. Greene also served as Carnegie's Secretary following Pearl's resignation in January 1999. On February 15, 1999, Bennett Goldstein, a certified public accountant, became Carnegie's Chief Financial Officer ("CFO"). Goldstein served in that capacity until September 10, 1999. Prior to becoming Carnegie's CFO, Goldstein was a partner in the Baltimore office of Grant Thornton.

Grant Thornton is an Illinois limited liability partnership with offices throughout the United States. Grant Thornton maintains an office in Baltimore, Maryland. Flach is the Managing Partner of Grant Thornton's Baltimore office. Stanley Krosin was the Quality Assurance Partner for the Baltimore office.

Grant Thornton has a National Office of Assurance Services and Regional Directors of Assurance Services. The Regional Directors provide assistance to Grant Thornton's operating offices by (i) consulting with the personnel in those offices on matters relating to accounting, auditing and the rules and regulations of regulatory agencies, such as the SEC, and (ii) responding to technical inquiries pertaining to client engagements. Grant Thornton's Baltimore office is in the Northeast Region. Joseph Graziano was the Regional Director of Accounting and Auditing Services for the Northeast Region when Grant Thornton conducted the audit of

Carnegie's December 31, 1997 financial statements. Gary Illiano was the Regional Director of Accounting and Auditing Services for the Northeast Region during the period when Grant Thornton conducted review procedures on Carnegie's Form 10-SB and the audit of Carnegie's December 31, 1998 financial statements.

In March, 1996, A & W entered into an Exchange Agreement with a British Virgin Islands corporation, Grandname Limited. A & W agreed to exchange its common stock for the stock of Electronic Card Acceptance Corporation ("ECAC"), a Virginia corporation, and DAR Products Corporation ("DAR Products"), a Maryland corporation. This transaction closed on May 3, 1996 making ECAC and DAR Products wholly owned subsidiaries of A & W. On September 10, 1996, Carnegie, Grandname Limited, ECAC and DAR Products entered into a Settlement Agreement wherein the parties agreed to the allocation of various securities, including shares of Carnegie stock, among the owners of ECAC and DAR Products and Grandname Limited.

For the year ending December 31, 1996, Carnegie reported a net loss of $709,347.

On April 16, 1997, ECAC sold a portion of its merchant accounts to First USA Merchant Services, Inc. ("First USA") for cash in the amount of $3,700,000. On September 15, 1997, Carnegie's board of directors approved a plan to spin off DAR Products to Carnegie's shareholders. The spin-off was completed in October 1997. Prior to the spin-off, DAR Products did not produce any revenues. Effective in August 1997, Carnegie acquired a Victoria Station Restaurant in Florida.

On September 29, 1997, Carnegie acquired the stock of Profit Thru Telecommunications (Europe) Limited ("PTT"), a United Kingdom corporation, and Talidan Limited ("Talidan"), a British Virgin Islands corporation in exchange for Carnegie stock, options and warrants. PTT was a software company that was engaged in developing a series of interactive voice response software products. Talidan was in the business of providing adult entertainment services.

For the year ending December 31, 1997, Carnegie reported in its Form 10-SB, which was filed with the Securities and Exchange Commission ("SEC") on October 28, 1998, that it earned net income of $1,579,835. The results from operations of Carnegie's three industry segments were: (i) financial services (ECAC) – $3,123,989 in income before taxes; (ii) telecommunications (PTT and Talidan) – $65,567 in income before taxes; and (iii) restaurant (Victoria Station) – $5,310 in income before taxes.

But for ECAC's sale of the merchant accounts to First USA, for the year ending December 31, 1997, Carnegie would have reported a net loss from all of its consolidated operations.

During 1998, Carnegie reported that it sold and acquired several businesses:

(i) Carnegie sold the stock of ECAC (Europe), Ltd. to Alpina Tours LLC on January 6, 1998 for a $250,000 promissory note;

(ii) Carnegie sold the stock of ECAC to Value Partners on January 30, 1998 for cash in the amount of $100,000;

(iii) Carnegie acquired ACC Telecom, a reseller of equipment and business telephone systems, on February 1, 1998;

(iv) Carnegie sold a portion of the assets of Talidan known as the "print media business" to Westshire Trading Company, Inc. ("Westshire"), a Bahamas corporation, on June 22, 1998 for a $2,340,000 promissory note;

(v) Carnegie acquired Voice Quest, Inc. ("Voice Quest"), a developer and provider of speech recognition and voice mail technology products, on November 20, 1998;

(vi) Carnegie acquired RomNet Support Services, Inc. ("RomNet"), an e-business and technical support services company on December 1, 1998; and

(vii) Carnegie sold software and the rights to distribute certain software products to Tiller International in Russia, on December 8, 1998, in exchange for the relinquishment of certain put option rights.

For the year ending December 31, 1998, Carnegie reported that it earned net income of $2,660,927. This reported income included gains, net of costs, of $1,596,273 on the sale of Talidan's print media assets; $1,391,881 on the sale of ECAC and ECAC (Europe); and $3,107,564 on the sale of the software and distribution rights. For this year, Carnegie reported the results of operations of its other subsidiaries as follows: (i) Victoria Station – $134,150 in income before taxes; (ii) ACC – $68,787 in income before taxes; (iii) RomNet – $16,501 loss; and (iv) Voice Quest – $11,991 loss. Without including the reported gains on the dispositions of the stock or assets of ECAC, ECAC (Europe), Talidan and the MAVIS software rights, for the year ending December 31, 1998, Carnegie would have reported a net loss from consolidated operations of several million dollars.

In December 1997, Carnegie engaged Grant Thornton to audit Carnegie's December 31, 1997 financial statements. Grant Thornton performed the following services for Carnegie:

(i) Grant Thornton audited Carnegie's December 31, 1997 financial statements. As part of this engagement, Grant Thornton also audited Carnegie's December 31, 1996 financial statements. Grant Thornton issued an unqualified opinion stating that Carnegie's December 31, 1997 and 1996 financial statements presented fairly, in all material respects, the consolidated financial position, consolidated results of operations, and cash flows of Carnegie and its subsidiaries for those periods in conformity with Generally Accepted Accounting Principles ("GAAP").

(ii) Grant Thornton performed review procedures on Carnegie's Form 10-SB, which Carnegie filed with the SEC on October 28, 1998. The Form 10-SB attached Carnegie's December 31, 1997 and 1996 financial statements, which Grant Thornton audited, and financial statements for the six-month period ending June 30, 1998, which were not audited by Grant Thornton.

(iii) Grant Thornton assisted Carnegie in responding to comments made by the SEC staff on Carnegie's Form 10-SB, Form 10-SB/A and Form 10-KSB.

(iv) Grant Thornton performed review procedures on Carnegie's Form 10-SB/A, which Carnegie filed with the SEC on February 12, 1999. The Form 10-SB/A attached Carnegie's December 31, 1997 and 1996 financial statements, which Grant Thornton audited, and financial statements for the nine-month period ending September 30, 1998, which were not audited by Grant Thornton.

(v) Grant Thornton audited Carnegie's December 31, 1998 financial statements. Grant Thornton issued an unqualified opinion stating that Carnegie's December 31, 1998 financial statements presented fairly, in all material respects, the consolidated financial position, consolidated results of operations, and cash flows of Carnegie and its subsidiaries for that period in conformity with GAAP. Carnegie's December 31, 1998 financial statements and Carnegie's December 31, 1997 financial statements (restated) were attached to its Form 10-KSB, which was filed with the SEC on April 27, 1999.

Carnegie terminated Grant Thornton on September 23, 1999.

Additional and more detailed findings of fact are presented throughout the Court's discussion.

III. DAMAGES

A. Carnegie Failed to Prove Compensatory Damages

Carnegie alleges that "Grant made numerous and serious audit errors in its 1997 and 1998 Carnegie audits, failed to follow the Generally Accepted Accounting Principles ("GAAP") and Generally Accepted Auditing Standards ("GAAS"), caused Carnegie to file restated financial statements, and caused the trading of Carnegie stock on the American Stock Exchange to be halted. This in turn caused the value of Carnegie stock to plummet, caused Carnegie to lose profits and opportunities from pending business deals, and caused millions of dollars of damage to Carnegie." Plaintiff's Proposed Findings of Fact & Conclusions of Law ("Plaintiff's Proposed Findings") at p 3. Assuming the truth of Carnegie's assertions of Grant Thornton's failings, Carnegie's claims fail for lack of proof of causation and lost profits and opportunities.

Under Maryland law, a plaintiff bears the burden of proving its damages with reasonable certainty. See Roebuck v. Steuart, 76 Md. App. 298, 314, (1998) (citations omitted). Damages which are based on conjecture, or are uncertain, contingent, or speculative, cannot serve as a basis for recovery. See, e.g., Asibem Assoc. v. Rill, 264 Md. 272, 276-81 (1972) ("[I]f compensatory damages are to be recovered, they must be proved with reasonable certainty, and may not be based on speculation or conjecture.") (citations omitted). "It is the general rule that one may recover only those damages that are affirmatively proved with reasonable certainty to have resulted as the natural, proximate, and direct effect of an injury." Empire Realty Co. Inc. v. Fleisher, 269 Md. 278, 284 (1973) (citations omitted).

> Maryland cases . . . are all consistent in rejecting the proposition that the jury may form a judgment or conclusion on the basis of testimony which admits of mere possibilities and have stated in various cases that the test to be applied, whether the question involved is the existence of an injury or its cause, is reasonable probability or reasonable certainty. Thus, evidence of prospective

> damages must be in terms of the certain or probable and not of the possible. In the law, as is true in common usage, 'probability' exists when there is more evidence in favor of a proposition than against it; mere 'possibility' exists when evidence is anything less.

Davidson v. Miller, 276 Md. 54, 62 (1975) (citations omitted).

Carnegie argues that lost profits, measured by the "relaxed standard" set forth in the contract case of M & R Contractors & Builders, Inc. v. Michael, 215 Md. 340 (1958), are the proper measure of damages for Grant Thornton's actions. M & R Contractors, an action addressing lost profits in sales contracts, is inapplicable to the facts of this case. However, even if this Court were to accept the standard advanced by Carnegie, including the relaxed standard permitting "the extent or the amount [of damage to] be left to reasonable inference," Carnegie would not have met its burden to prove damages as to any of the claims tried.

Carnegie called two experts to testify on damages. Dr. Marcia Kramer-Myer addressed causation. She opined that 1) benefits inure to companies listed on the various stock exchanges and 2) delisting causes a decline in a company's stock price. She did not offer any opinion as to the measure of these damages in Carnegie's case.

Carnegie relied almost exclusively on the opinion testimony of expert Dr. David I. Tabak, Ph.D. Tabak proffered two methodologies for quantifying Carnegie's alleged damages. The first methodology was an effort to quantify the profits claimed to have been lost in the failed expansion of Carnegie's business (Negotiations ensued between Electronic Data Systems, Inc. ("EDS") and Paramount International Telecommunications, Inc. ("Paramount") prior to the trading halt.) and of Carnegie's loss of existing business. Tabak opined that damages under this first method of calculation were $123,610,759 and $21,924,374, respectively, for a total of $145,535,133. The second methodology purported to measure Carnegie's lost market capitalization as a result of the trading halt. Tabak opined that damages under this second method of calculation were $446,603,758.

1. Carnegie Failed To Prove It Suffered The Loss Of Any Expansion Opportunity

Tabak's opinion as to the loss of expansion of Carnegie's business under the first methodology is contingent upon factual determinations that 1) Paramount would have entered into a transaction with EDS to place broadband internet access into hotel rooms, but for the trading halt and 2) the success of the transaction would have mirrored the projections made by EDS. Neither of these necessary predicates were supported by credible evidence.

No contract between Paramount and EDS was ever executed. The credible evidence on this point was from Daniel Zadorozny, attorney for EDS, and the individual responsible for drafting the contract for the proposed transaction. He testified, and the Court finds, that Eric Nelson never supplied Zadorozny with crucial terms for the contract, including pricing terms and a description of services to be provided by each of the parties. The Court also finds that by July 1999, any concept of profit sharing between EDS and Paramount had been eliminated from the proposed transaction. As of that time, EDS was agreeing only to sell services to Paramount. The Court finds that Nelson never attempted to obtain the required approvals from EDS for a joint venture arrangement.

The testimony to the contrary was not credible and came principally from Nelson who had no authority to bind EDS. No one with authority to bind EDS testified that there had been an agreement between Paramount and EDS. Carnegie produced one of several drafts. The draft produced came from Nelson's home office where he stored it after he left the employ of EDS. Neither the draft nor Nelson's testimony convinced this Court that the operative terms had been agreed upon. There was no such deal and no basis to compute damages on the negotiations which may, or may not, have ultimately resulted in a contract.

Tabak's second premise for this damage calculation (loss of expansion of business) also fails for lack of a factual foundation. There was no credible evidence that the success of the proposed transaction between EDS and Paramount would have mirrored the projections made by EDS. Tabak's opinion was not premised on any significant research into the broadband hotel market and he did not verify the accuracy of the projections upon which he based his calculations. Tabak relied on the projections made by David Moody and Nelson of Paramount and EDS, neither of whom convincingly described the basis for these projections. Those projections were shown to be unrealistic by credible evidence establishing that Tabak's projection of profits for this single proposed venture exceeded those for the entire industry in 2000 and 2001.

Grant Thornton's damages expert, Dr. Kenneth Cone, made a study of the broadband hotel market and testified convincingly. Based on his testimony and that of others, the Court accepts the opinion that the high-speed internet access business was a new and untried business venture at the time. The business model of the proposed venture was unrealistic and, if implemented, would not have been successful. Tabak's projections extended into the indefinite future and there is no evidence to support an indefinite term agreement. Accordingly, the Court finds that Carnegie's/Tabak's first method of calculating damages, based on the proposed transaction between Paramount and EDS, lacks a sufficient basis in fact, and is too speculative and uncertain to permit an award of damages.

The remaining portion of Tabak's first method for calculating damages is variously stated by the parties as involving a purported reduction in Carnegie's future cash flows (Grant Thornton), and a loss of ongoing profits (Carnegie).

Tabak's calculation of damages using this methodology is flawed and, therefore, not accepted. Tabak focused on a period of time, long after the trading halt, that produced the highest possible damage figure. If Tabak had chosen to compare the period prior to the trading halt with the period after the trading halt, the calculation of damages would have been nearly zero. Moreover, the time period used in this method of analysis differed from the time period Tabak used in his market analysis (which used the stock price on the date of the trading halt).

Nearly all of the effects on Carnegie's cash flows found by Tabak can be explained by the drop in Paramount's business from 1999 to 2000. That drop resulted from an increase in the use of cell phones by hotel customers and not from anything having to do with the trading halt. Tabak's calculation was also flawed because he made no attempt to disentangle other negative news about Carnegie unrelated to the trading halt from the negative news of the trading halt itself. See infra at 12.

In short, Tabak's opinion as to this second measure of damages is unconvincing. The Court declines to accept his opinion that Carnegie suffered $21,924,374 for loss of existing business. These damages were not proved to a reasonable degree of certainty because Tabak's projections are too speculative.

2. Carnegie Failed to Prove Lost Market Capitalization Resulting from the Trading Halt

Tabak's second method of calculating damages was based on an alleged decline in Carnegie's market capitalization. This method assumed (i) that the price at which Carnegie's stock traded on the American Stock Exchange ("AMEX") (on April 28, 1999) was an accurate reflection of the market's expectations of Carnegie's future cash flows, and (ii) that a loss in market capitalization constitutes harm to a company rather than to the company's shareholders. Using this theory, Tabak calculated a drop in Carnegie's market capitalization of $446,603,758.

Tabak's second methodology assumes that the amount of the reduction of market capitalization is a harm to Carnegie. The credible evidence, however, from the testimony of Kramer-Mayer and Cone was that the effects of trading and liquidity are primarily a benefit to the shareholders. Carnegie, therefore, cannot recover for any such reduction.

Additionally, this second method is flawed because Tabak failed to take into consideration material information that artificially inflated the price of Carnegie's stock prior to the trading halt. He failed to adequately consider the effects of Carnegie's erroneous accounting for the ECAC, ECAC (Europe), Westshire, and Russian transactions, and the effects of Carnegie's failure to disclose the severe problems with Talidan, eventually resulting in its shutdown. Tabak also failed to consider 1) the effects of Carnegie's failure to disclose that it was not profitable in 1998; 2) the effects of Carnegie's failure to disclose that its major source of cash was its dealing in its own stock; 3) the effects of Carnegie's failure to disclose that MAVIS was not a marketable product; and 4) the effects of Carnegie's failure to disclose that Voice Quest and RomNet were not successful.

The market sets stock value based on expected future cash flows. The sources of Carnegie's cash flows were not from its operations. The sources were from sales of its own stock. Such a circumstance does not create any real value, and it does not support the market's expectations of future cash flows. Accordingly, Cone opined that the stock price Tabak used as his starting point to calculate the loss of market capitalization damages did not reflect Carnegie's fundamental economic value and was not, therefore, an appropriate starting point for the calculation of damages. Cone opined further that 1) the drop in Carnegie's stock price, after the trading halt, simply eliminated an artificial valuation and 2) the drop was not an accurate depiction of a loss in market capitalization. The Court accepts his opinions.[2]

There is no reasonable basis in the record upon which to find, as did Tabak, that Carnegie would have earned over $100,000,000 in the future or would have obtained a market capitalization of over $400,000,000.

Finally, Tabak neglected in both of his methodologies to consider the track record for business ventures Carnegie attempted. Carnegie's history was one of failure. Cone delineated those failures. First, DAR Products was one of the two companies Carnegie initially acquired in approximately May 1996. No products covered by the patents owned by DAR Products were ever sold, and Carnegie abandoned this line of business when it decided, in September 1997, to spin off DAR Products to its shareholders. Second, Carnegie sold most of ECAC in or about May 1996, within a year of acquiring it, due to its declining profit margins and increased

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[2] At trial and again in its proposed findings of fact and conclusions of law, Carnegie disparages Dr. Cone with a footnote in the case of *Blue Bonnet Savings Bank v. United States, 47 Fed. C. 156, 176 n.95 (Fed. Cl. 2000).* This Court thinks no less of Cone because of that footnote. Cone was knowledgeable, prepared, forthright, and most importantly, credible in this trial.

competition. Carnegie then sold the remainder of this business for $100,000 cash in January 1998. Third, Victoria Station essentially broke even for two years, but ultimately was closed due to lack of business. Fourth, PTT never produced any revenues, and its MAVIS product was never commercially viable. Fifth, Talidan initially produced some revenues. By early 1999, however, the business was experiencing severe difficulties, and a few months later Carnegie shut down Talidan's operations completely. Sixth, ACC Telecom ("ACC") and Voice Quest were touted as having synergy with MAVIS, but the Voice Quest product was determined to be incompatible with MAVIS. By 1999, Carnegie described the ACC deal as "disappointing." Seventh, RomNet was not profitable.

In addition, Carnegie announced transactions that were unsuccessful, including one with the Alltel Corporation ("Alltel"). Alltel terminated the contract. The announced distribution of MAVIS in Russian, Italian and Swiss did not result in any sales of the product. The BCT/Telus deal with Paramount, which Carnegie declared as highly profitable, was rejected by BCT/Telus as not economically viable.

Carnegie's only profitable year of operations was 1997 when Carnegie earned $1,579,835 in net income. Absent the gain on the sale of the merchant accounts of ECAC to First USA, however, which was a one-time transaction, Carnegie would have reported a substantial loss in 1997.

Cone took the above facts into account in expressing his opinion that, assuming Carnegie could prove liability, Carnegie suffered no damages. Cone opined that the value of Carnegie was inflated by overly optimistic projections and the dissemination of incorrect information regarding its revenues and products. Once the misinformation was fully disclosed, the market value of Carnegie's stock fell to its proper level. Carnegie's stock price fell because the truth about Carnegie's business (and the true source of revenues) was disclosed. The

Court accepts the opinion of Cone. Under such circumstance, there is no basis to calculate any damages resulting from the trading halt or the activities of Grant Thornton.

Carnegie failed to prove to a reasonable degree of certainty that it suffered any damages. Carnegie failed to present sufficient evidence upon which the Court could base any award of damages against Grant Thornton. Carnegie's claimed damages are based on conjecture and are uncertain, are contingent or are too speculative to serve as a basis for recovery under any of the claims brought against Grant Thornton.

B. Carnegie Cannot Recover Punitive Damages

Carnegie seeks punitive damages for its claims for fraud, breach of trust and tortious interference with its contract.[3]

Maryland law provides for an award of punitive damages only if there is an award of compensatory damages and the plaintiff establishes, by clear and convincing evidence, that the defendant acted with "actual malice." Phillip Morris Inc. v. Angeletti, 358 Md. 689, 773 (2000); Alexander & Alexander Inc., 336 Md. 635, 649-52 (1994); Caldor v. Bowden, 330 Md. 632, 661 (1993). Carnegie failed to prove either of the prerequisites for a punitive damage award.

First, as set forth above, Carnegie has failed to prove entitlement to compensatory damages. Second, there is no credible evidence that Grant Thornton acted with actual malice. "Actual malice" requires that the defendant act with an evil motive, an intent to injure, ill will or fraud. See Ellerin v. Fairfax Sav., F.S.B., 337 Md. 216, 234 (1995).

Carnegie invites this Court to find an “inference of Grant’s actual malice in 1) the alleged egregiously fraudulent misrepresentations of its personnel’s public company auditing and Securities and Exchange Commission (“SEC”) regulatory compliance expertise before inception of the Carnegie engagement; 2) the alleged sequential acts of cover-up of its negligence after

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[3] Carnegie’s other claims for punitive damages were dismissed before trial.

the April 30, 1999 stock trading halt"; and 3) Grant Thornton's alleged intentional interference with the Westshire note repayment and related breach of trust. Plaintiff's Proposed Findings at 210.

This Court finds that Grant Thornton did not misrepresent its expertise, infra at 36-39, did not cover up any negligence, infra at 43-44, did not intentionally interfere with the Westshire note repayment, infra at 44, did not commit a breach of trust, infra at 39-41, and did not engage in any other tortious or fraudulent conduct. Accordingly, there is no basis to consider an award of punitive damage to Carnegie.

IV. GRANT THORNTON WAS NOT NEGLIGENT

Under Maryland law, a plaintiff asserting a cause of action in negligence must prove, by a preponderance of the evidence, that (i) the defendant owed a duty to the plaintiff which required conformance to a certain standard, (ii) the defendant breached the duty, (iii) the plaintiff suffered actual injury or loss, and (iv) the loss or injury proximately resulted from the defendant's breach of duty. Shofer v. Stuart Hack Co., 124 Md. App. 516, 528 (1999) (citing W. Page Keeton et al., Prosser and Keeton on the Law of Torts, § 30, at 164-65 (5th Ed. 1984); Rosenblatt v. Exxon, 335 Md. 58, 76 (1994)); Suburban Hosp. Ass'n v. Mewhinney, 230 Md. 480, 484-85 (1963).

A. Grant Thornton Complied With Applicable Standards of Care

An independent auditor has a duty to use that degree of care and skill that a reasonable, competent independent auditor acting in similar circumstances would use. See Restatement (Second) of Torts, § 299A ("Unless he represents that he has greater or less skill or knowledge, one who undertakes to render services in the practice of a profession or trade is required to exercise the skill and knowledge normally possessed by members of that profession or trade in good standing in similar communities.").

The credible evidence is that Grant Thornton held itself out to possess the skill and knowledge normally possessed by members of its profession and that it had experience with the rules and regulations of the SEC. To comply with its duty in this case, Grant Thornton was thus obligated to perform its work for Carnegie in accordance with GAAS and with that degree of skill and care that a reasonable, competent independent auditor, familiar with the rules and regulations of the SEC, would use in similar circumstances.

1. Russian Transaction

a. Initial Accounting

Carnegie alleges that "Grant committed myriad GAAP and GAAS violations, most important of which was its erroneous accounting for the put feature liability and proper revenue recognition in the Russian transaction." Plaintiff's Proposed Findings at p.144. Carnegie, however, has failed to prove, by a preponderance of the evidence, any breach of duty entitling it to relief.

Carnegie reported $3,100,000 on its December 31, 1998 audited financial statements as a gain on the Russian transaction. The SEC questioned that reporting, as well as other aspects of those statements. Carnegie claims that "the Russian transaction, from beginning to end, should at all times have been reported as an equity transaction, with no revenue capable of being recognized. Grant knew, at least as of November 21, 1998, that the transaction was structured to eliminate the put feature liability." Plaintiff's Proposed Findings at p. 67. Carnegie also claims that this erroneous reporting of revenue was the primary cause of the SEC's concerns, the reason its staff telephoned the staff of the AMEX with its concerns, and the ultimate cause of the halt in the trading of Carnegie's stock.

On September 29, 1997, Carnegie acquired PTT and Talidan. It negotiated the transaction with an overseas entity known as Tiller Holdings. As consideration for the acquisition, the owners of PTT and Talidan and various entities affiliated with Tiller (collectively "Tiller Entities") received stock, options, and warrants from Carnegie.[4] The stock options carried both a put and a call option.

The put and call options were related. As the market price of Carnegie stock increased, the number of shares that could be acquired by the option holders through exercise of the call options decreased. As the price fell, the number of shares that could be acquired increased. The holders of the options instead could elect to exercise a put option three years from the date of Carnegie's acquisition of PTT. The number of shares that would be acquired and then put back to Carnegie also was determined by a formula. The value of the shares at the date the puts could be exercised, however, was always equal to $5,000,000.

On the advice of Grant Thornton, Carnegie recorded a liability for the puts ("Put Option Liability") on its December 31, 1997 financial statements. This accounting treatment was proper under applicable accounting principles because it was probable that the puts would be exercised instead of the calls. This was probable because, in exercising the calls, the option holder received shares of Carnegie stock that were restricted. Therefore, the economically logical thing for the option holders to do was wait and exercise all of the puts and then put the shares back to Carnegie for $5,000,000. If the persons who exercised the puts wished to own shares of Carnegie stock, they could then use the $5,000,000 to purchase "free trading" shares of Carnegie stock at that point in time.

On April 27, 1998, Goldstein, while a partner at Grant Thornton, drafted a memorandum to the audit file that explained the basis for the Put Option Liability and the amount at which that liability was carried on Carnegie's books. Based on the discounted value of the liability, the Put

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[4] As used herein, the term "Tiller Entities" is inclusive of Tiller International and Tiller Holdings.

Option Liability was $3,756,574 as of December 31, 1997. Goldstein also discussed the Put Option Liability issue with Gable, Farkas and Pearl, all of whom agreed that it was more likely the puts would be exercised than the calls. Thus, Grant Thornton's advice regarding Carnegie's treatment of the put option as a liability was proper under GAAP.

In October 1998, Gable met with Anthony Georgiou of the Tiller Entities to discuss a restructuring of the shares, option and warrants that had been issued to various entities affiliated with Tiller as part of the consideration paid by Carnegie to acquire PTT and Talidan in September 1997.

As a result of these discussions, Gable and Georgiou agreed to a transaction whereby: (i) Carnegie would find a third party to purchase most of the Tiller Entities' shares, options and warrants for $2,500,000; and (ii) Carnegie would grant Tiller the rights to distribute MAVIS in Russia in exchange for the Tiller Entities' relinquishment of their put option rights. At the conclusion of the meeting, Gable believed that he had a deal and that there was no doubt that Georgiou would arrange for the relinquishment of the put option rights. Moreover, Gable thought that Carnegie would get the Put Option Liability extinguished as a result of this deal.

On November 20, 1998, Gable and Farkas inquired of Goldstein, still a Grant Thornton partner at the time, about revenue recognition on the deal Gable had fashioned with Georgiou, that is, the sale to Tiller Entities of the rights to distribute MAVIS in Russia to be paid for by Tiller Entities, Carnegie stock, and the relinquishment of the put option rights. Goldstein informed Gable, Farkas and Pearl that, if the transaction involved an exchange of Carnegie stock for the distribution rights, GAAP prohibited revenue recognition.

Carnegie and Tiller Entities negotiated a Heads of Terms, which was executed on November 28, 1998, setting forth the terms of the two transactions. There were no substantial changes to the verbal agreement that Gable had negotiated with Georgiou in October 1998. The Heads of Terms thus provided for the sale of the Tiller Entities' stock, options and warrants for $2,500,000 and for the grant by Carnegie to Tiller Entities of the rights to distribute MAVIS in Russia for the relinquishment of the put option rights owned by the Tiller Entities. The primary purpose of the Heads of Terms was to eliminate Carnegie's existing $5,000,000 put feature liability.

The Tiller Entities executed documents later in December 1998 surrendering their put option rights. These documents were delivered to Carnegie.

On December 9, 1998, and again on December 10, 1998, Carnegie issued a press release announcing the deal to distribute MAVIS in Russia, as the sale to Tiller Entities of 1,000 copies of MAVIS software in the Russian and English languages, for a price of $3,700,000. These press releases did not mention Carnegie stock as any part of the consideration for the deal.

This Distribution Agreement stated that the consideration received by Carnegie for the grant of the distribution rights to Tiller Entities was the surrender of the put options that had a face value at maturity of $5,000,000. Thus, by the terms of the Distributor Agreement, Carnegie had eliminated a substantial liability (in the form of the Put Option Liability) from its balance sheet as of December 8, 1998.

In a letter dated February 12, 1999, Carnegie informed the SEC staff of the Russian transaction. The Distributor Agreement, dated as of December 8, 1998, between Carnegie and Tiller Entities was attached as an exhibit to its Form 10-SB/A filed by Carnegie with the SEC on December 8, 1998.

On February 27, 1999, Goldstein, as the CFO of Carnegie, forwarded a copy of the Distributor Agreement to Grant Thornton along with a memorandum in which he stated that revenue recognition on the Russian transaction was appropriate. Shortly thereafter, in March, 1999 the fieldwork began on the 1998 audit. It continued through mid-April 1999. Craig Miller, the manager on the 1998 audit team, reviewed the Distributor Agreement, and, on March 5, 1999, he prepared a memorandum determining that one month of revenue should be recognized on the Russian transaction for 1998. This memorandum was sent to the other members of the audit team and to Illiano as Regional Director of Accounting and Auditing Services for Grant Thornton. Miller noted in his memorandum a number of assumptions he had made and several open questions he had about the transaction.

On March 8, 1999, Morton Goldman, Grant Thornton's audit engagement partner, sent an e-mail to Goldstein raising several issues concerning the accounting for the Russian transaction. On March 9, 1999, Goldstein sent Grant Thornton a memorandum responding to Goldman's questions and providing additional information about the transaction. In the memorandum, Goldstein represented that all aspects of the Distributor Agreement had been satisfied by Carnegie and that revenue recognition on the transaction was therefore proper. He also stated that accounting for the transaction was governed by the Statement of Financial Accounting Standards (SFAS) 45.

Under Accounting Practice Bulletin 29, in accounting for a transaction of this nature, the transaction is valued by determining the value of what is given up or the value of what is received by the company. In this instance, the value of extinguishing the puts was readily ascertainable, so that value was used by Carnegie and Grant Thornton to determine the value of the Russian transaction and the amount of revenue to be reported.

In order to recognize revenue, however, the Russian transaction had to be fully completed in 1998, and Carnegie also could not have any continuing obligations to Tiller Entities in the future. After discussions with Goldstein, as CFO of Carnegie, and a review of the relevant accounting literature, Grant Thornton preliminarily agreed that Carnegie's accounting for the Russian transaction was reasonable and appropriate under GAAP. At this time Grant Thornton was aware of the Distributor Agreement itself, Carnegie’s press releases in December, 1998 and its February, 1999 letter to the SEC.

Grant Thornton received repeated representations from Carnegie that the Russian and English language versions of the MAVIS software had been delivered to Tiller Entities. The performance of this obligation was a condition precedent to revenue recognition on the transaction. Carnegie's representations in this regard were false.

On April 8, 1999, Georgiou faxed to Farkas a copy of an Amended Distributor Agreement. Georgiou acknowledged in writing that Tiller Entities had received the MAVIS software on December 18, 1998. The cover sheet of this April 8, 1999 fax, however, made it clear that the Amended Distributor Agreement was signed around April 8, 1999 and that, as of that date, no software had been delivered by Carnegie or PTT to Tiller Entities. Although the acknowledgment of software receipt was given to Grant Thornton, reviewed by it, and relied upon by it, the cover sheet of this document was not shown to Grant Thornton. Based on the acknowledgment, and without knowledge of the cover sheet, Grant Thornton concluded that revenue recognition on the Russian transaction was reasonable.

b. Accounting After Discovery of Call Option Exercises

During the course of the audit, Grant Thornton reviewed the 1998 stock transactions and discovered that twenty-five percent (25%) of the call options had been exercised in November 1998, prior to the date Carnegie claimed that the Distributor Agreement had been executed.

Carnegie alleges that this exercise of twenty-five percent (25%) of the call options changed the probability analysis under Emerging Issues Task Force (EITF) 84-5. It claims the Put Option Liability should have been treated as an addition to equity. It claims Grant Thornton failed to properly audit the Russian transaction because it did not reconsider the accounting treatment of the Put Option Liability under EITF 84-5 or obtain sufficient competent audit evidence regarding the transaction.

The effect of the holders exercising twenty-five percent (25%) of the call options was to eliminate the ability of those holders to exercise the associated put option rights. Thus, the amount of the puts remaining as of the purported date of the Distributor Agreement was seventy-five percent (75%) and the associated liability for those remaining put options was seventy-five percent (75%) of the total Put Option Liability. As a result, twenty-five percent (25%) of the value of the Put Option Liability was credited to additional capital/equity, the effect of which was to reduce the discounted amount of the Put Option Liability to $3,100,000. This reduced amount was the amount that Carnegie reported in its December 31, 1998 financial statements as a gain on the Russian transaction.

On March 15, 1999, Goldstein, as CFO of Carnegie, sent a copy of the stock option agreement (for the acquisition of PTT and Talidan) to Brooke Tucker, an appraiser with AMEX. Goldstein informed Tucker that twenty-five percent (25%) of the call options had been exercised on November 25, 1998. On March 24, 1999, Goldstein sent a memorandum to Goldman reporting that American Express opined that the value of the put options was $3,100,000. On April 22, 1999, Grant Thornton received a copy of the appraisal dated March 29, 1999 from American Express. As expected, the appraisal concluded that the value of the seventy-five percent (75%) of the puts relinquished in exchange for the software and the grant of the rights to distribute MAVIS was $3,100,000. Three million, one hundred thousand dollars ($3,100,000) was the amount of the remaining Put Option Liability after deducting the value of twenty-five percent (25%) of the puts that had been extinguished when twenty-five percent (25%) of the call options had been exercised in November 1998. The date for which American Express determined the appraised value of the remaining seventy-five percent (75%) of the put options was December 8, 1998, the date on the Distributor Agreement and the date Carnegie represented as being the date the Russian transaction was completed.

Under GAAP, after the exercise of twenty-five percent (25%) of the call options, Grant Thornton was not required to revisit the question of the probability of the remaining seventy-five percent (75%) of the puts being exercised because the nature of the options always made it more probable that the put options would be exercised than would the call options.

Additionally, the remaining put option rights associated with the other seventy-five percent (75%) of the options had been surrendered, either by virtue of the Heads of Terms or the Distributor Agreement, prior to the exercise of the remaining call options. Thus, the exercise of twenty-five percent (25%) of the call options had no effect on the probability that the remaining seventy-five percent (75%) of the puts would be exercised.

The recordation of the Put Option Liability was proper under applicable accounting principles, including under EITF 84-5. The put option feature of the call options was an indebtedness that was likely to come due in the future and therefore the Put Option Liability was properly recorded in the December 31, 1997 financial statements. Carnegie offered no credible evidence, including no opinion testimony, to the contrary.

Late in the audit, Grant Thornton's Hillel Moerman discovered that all of the remaining seventy-five percent (75%) of the call options had been exercised on December 23, 1998. These call options were exercised by or on behalf of Treasure Bay, which received the options by assignment from the Tiller Entities. The fact that the remaining seventy-five percent (75%) of the calls had been exercised on December 23, 1998, did not affect the accounting for the Russian transaction. The Tiller Entities already had agreed to surrender their put option rights prior to that date. As Carnegie represented the facts to Grant Thornton, the accounting for the transaction complied with GAAP. The audit evidence reviewed by Grant Thornton, including the stock options agreements, the Distributor Agreement, the memoranda from Goldstein, the acknowledgment of receipt of the software by Tiller Entities in the Amended Distributor Agreement, the American Express appraisal and the representations by Carnegie's management, was sufficient for Grant Thornton to conclude that revenue recognition on the Russian transaction was reasonable and appropriate under GAAP.

Carnegie did not meet its burden to prove, by a preponderance of the evidence, that Grant Thornton breached the standard of care in auditing the Russian transaction.

2. Valuation of Restricted Stock

At trial Carnegie asserted liability premised on other aspects of Grant Thornton's performance related to the 1997 and 1998 audits. The Court addresses those other issues here.

On September 29, 1997, Carnegie acquired two companies, PTT and Talidan, by means of a stock exchange transaction. As a result of the transaction, the excess value of the stock used for the purchase of PTT and Talidan was required to be recorded on Carnegie's books as goodwill, an intangible asset.

On March 16, 1998, Goldstein, then the Grant Thornton partner assigned to the 1997 audit, reviewed worksheets provided by Carnegie and questioned whether the figures used by Carnegie for intangible assets were overvalued. Goldstein took three actions. He suggested that the value of the stock used to acquire PTT and Talidan needed to be adjusted downward to account for the fact the stock was restricted; he recommended that Carnegie obtain an appraisal; and he sent Carnegie's management a memorandum recommending that the stock be appraised. Goldstein specifically informed Carnegie's management that Carnegie needed to make the valuation and that Grant Thornton could not be involved in the process.

On March 18, 1998, Goldstein drafted another memorandum informing Carnegie's management of existing studies on restricted securities which discounted such stock by a range of twenty percent (20%) to ninety percent (90%). Goldstein performed this research in order to obtain independent information regarding the proper amount of discounts. Goldstein also spoke with Phillip Matz, a certified public accountant and a valuation expert, and recommended to Carnegie that it hire Matz. Goldstein warned Carnegie's management that the appraisal could be the subject of scrutiny by the SEC.

On March 19,1998, Gary Dahne, an employee of Carnegie, drafted a memorandum summarizing information he had gathered regarding discounts. Dahne concluded that the stock should be discounted as much as seventy and seven tenths percent (70.7%). Dahne also noted that "[l]arger discounts can be applied for larger quantities of stock . . ." Dahne sent this information to Richard Greene, a certified public accountant who, at that time, provided accounting consulting services to Carnegie. Dahne's memorandum was forwarded by Carnegie's General Counsel to Talidan's solicitors in London for their review.

On March 27, 1998, Craig Miller of Grant Thornton noted in a memorandum that the stock had been discounted seventy percent (70%) by Carnegie's management. Goldstein, still with Grant Thornton at the time, discussed the discount with Matz and Michael Egan of Legg Mason. In a memorandum to the work papers, he concluded that management's valuation of the stock appeared to be reasonable. In a memorandum dated April 3, 1998, Goldstein reported that Carnegie's management agreed to discounts between eighty percent and eighty-five percent (80-85%) based on its discussions with Matz. Goldstein was told that Matz would prepare a formal appraisal. He did not.

Grant Thornton did not dispute the reasonableness of that discount, but it did not rely on any appraisal in determining that the amount of the discount ultimately adopted by Carnegie (eighty-five and seven tenths percent (85.7%)) was reasonable. Grant Thornton affirmed the reasonableness of the discount by doing a cash flow analysis which produced a similar valuation.

On April 28, 1998, Goldstein informed Carnegie's management that Krosin of Grant Thornton's Baltimore office had requested that Grant Thornton's New York office review Carnegie's December 31, 1997 financial statements. They were so reviewed by Graziano, the Regional Director of Accounting and Auditing Services. Graziano requested that Carnegie obtain a formal appraisal to support the valuation of the stock. Goldstein wrote to Carnegie's management on May 1, 1998, advising it that the 1997 audit was complete, except for the appraisal.

On May 5, 1998, Carnegie sent to Matz, Goldstein's suggested language and other support for an appraisal. Goldstein immediately reminded Carnegie's management that Carnegie needed to obtain an appraisal. Matz never performed an appraisal, but Carnegie's management informed Goldstein that Matz agreed with Goldstein. Goldstein had done no appraisal. Rather, he had agreed that Carnegie's management's determination of the discount, as informed by Matz, albeit without a formal appraisal, was reasonable.

On May 7, 1998, Carnegie obtained another appraisal from Joseph Luongo who concluded that a discount of eighty-five percent (85%) was proper. Grant Thornton reviewed Luongo's credentials and at this time Grant Thornton and Carnegie both believed that Carnegie had properly determined the amount of the discount. The eight-five percent (85%) discount was used in preparing Carnegie's December 31, 1997 financial statement. The effect of using the eight-five percent (85%) discount was to reduce the goodwill of PTT and Talidan from approximately $17,000,000 to $6,000,000.

Carnegie did not present any credible evidence that this eight-five percent (85%) discount was not reasonable or that Grant Thornton failed to adhere to GAAP by using this discount in preparing Carnegie's 1997 financial statements.

<u>3. Change In the Discount on the Valuation of Stock</u>

Beginning December 30, 1998 and continuing until Grant Thornton was discharged, the SEC scrutinized Carnegie's acquisition of PTT and Talidan. The SEC initially scrutinized the transaction as a possible "reverse acquisition." The SEC dropped this concern only after Carnegie and the SEC came to a negotiated agreement that the amount of the discount would be fifteen percent (15%).

After the SEC had expressed concern, Goldstein sent the Luongo appraisal to the SEC staff on April 13, 1999. Two days later, the SEC asked Carnegie to explain how it reached a value of $.11 a share for the stock used to acquire PTT and Talidan. Carnegie responded with a suggestion that the stock be valued at $.53 a share. The SEC refused to accept a discount in excess of ten percent (10%). Shortly thereafter, on April 22, 1999, Carnegie and the SEC agreed that Carnegie would use a fifteen percent (15%) discount.

The December 31, 1997 financial statements were restated to reflect the use of a fifteen percent (15%) rather than an eighty-five percent (85%) discount. Carnegie filed its restated financial statements with the SEC on April 27, 1999 in its Form 10-KSB. Although Carnegie accepted this negotiated figure of fifteen percent (15%), neither it, nor Grant Thornton believed that the fifteen percent (15%) discount was a correct valuation of the stock. Carnegie agreed to the negotiated figure to get its Form 10-KSB filed and to move closer to its goal of listing its stock on the AMEX.

The Court accepts the expert opinion of Ernest Ten Eyck that the SEC's questioning of the discount and its ultimate decision to dictate a figure substantially lower than that in Carnegie's original financial statements is not unusual and does not mean that the original discount did not comply with GAAP.

The adoption of the fifteen percent (15%) discount resulted in an increase in the goodwill of PTT and Talidan which lead to an increase in Carnegie's balance sheet assets. That increase dictated that in future years, those increased assets would have to be amortized which would ultimately adversely affect (from Carnegie's point of view) the revenues reported.

4. Talidan's Impairment

Carnegie's experts did not express any credible opinion that Grant Thornton's 1997 audit work relating to impairment failed to comply with GAAS. Moreover, the Court concludes, based on the testimony of Ten Eyck, that Carnegie was responsible for performing an impairment analysis in the first instance. In 1997, Carnegie's management provided written representations to Grant Thornton that Talidan was not impaired. There is no credible evidence that Talidan was impaired during the 1997 year or that Grant Thornton failed to comply with GAAS in its auditing relating to this issue.

Carnegie's management represented that Carnegie's goodwill assets were not impaired. Statement of Financial Accounting Standards ("FAS") Number 121 requires that an impairment analysis be conducted in circumstances where an event occurs which would affect the ability of a company to recover the value of the goodwill (a "triggering event").

The FAS 121 analysis was Carnegie's responsibility and Carnegie determined that the goodwill for Talidan was recoverable over the life of the asset. This analysis was performed using the higher value for goodwill associated with Talidan. Although Goldstein counseled Carnegie's management regarding its responsibility to disclose any triggering event, Carnegie did not disclose any such event to Grant Thornton.

In February 1999, Carnegie's management received a memorandum that informed it of developments in the Brazilian telephone industry that would seriously affect Talidan's future income. Thus, by early 1999, Carnegie's management had knowledge of material facts and serious problems with Talidan's business, but it did not disclose this information to Grant Thornton or to the SEC despite the fact that, at this time, it was undertaking the prerequisites to be listed for trading on the AMEX.

In May 1999, Goldstein, now at Carnegie, received reports of Talidan's first quarter 1999 revenues. Those revenues had decreased to the point that Goldstein expressed concern about the possible impairment of Talidan. At that time, neither Goldstein (at Carnegie) nor Grant Thornton was aware that Talidan's business actually had been suspended. Carnegie eventually disclosed this potential impairment of Talidan in a draft Form 10-QSB which it sent to the SEC on May 25, 1999. The SEC asked Carnegie to explain the circumstances involving Talidan's intangible assets.

On June 1, 1999, Talidan's management sent an e-mail to Carnegie's management giving additional details of the problems in the Brazilian telephone industry. Grant Thornton was informed of these issues for the first time on or about June 4, 1999. (Communications between Carnegie and Grant Thornton essentially ceased on or about May 7, 1999 when Carnegie hired a law firm to represent it in matters related to Grant Thornton's performance.)

After the trading halt, Carnegie sought to reopen the issue of the valuation. In part, Carnegie did so because of concerns with a possible impairment of the amounts recorded for Talidan's goodwill. On June 9, 1999, Carnegie obtained a new appraisal of the stock used to acquire PTT and Talidan, which valued the stock using an approximate fifty-five percent (55%) discount.

In its July 2, 1999 response to questions raised by the SEC in the May 27, 1999, comment letter, Carnegie disclosed that Talidan had suffered impairment losses of over $5,000,000 in the third quarter of 1998 and that its December 31, 1998 financial statements would be restated to account for these losses. Carnegie also disclosed that payments from the Brazilian national telephone company had been suspended and, as a result, Talidan had suspended its business.

On July 12, 1999, Carnegie reported that the SEC accepted a thirty-three percent (33%) discount to value the stock issued to acquire PTT and Talidan. Using that thirty-three percent (33%) discount, in a July 28, 1999, letter to the SEC, Carnegie reported an impairment loss of $5,700,000 for Talidan and stated that it expected to sell Talidan. Thereafter, on August 3, 1999, Carnegie provided further information to the SEC staff about the impairment of Talidan and the SEC raised more questions.

On August 18, 1999, Talidan's management informed Goldstein of the information they had given to Carnegie's management in February 1999 and Goldstein informed Grant Thornton for the first time.

There was no credible evidence that Grant Thornton violated GAAS with regard to the impairment issue. Grant Thornton had no basis for conducting a FAS 121 analysis in the absence of knowledge of a triggering event. Carnegie's management had such knowledge, but, for whatever reason, elected to keep that information from its auditors and its CFO (Goldstein) until Goldstein (while at Carnegie) stumbled upon news of Talidan's possible impairment.

Carnegie failed to prove by a preponderance of the evidence that Grant Thornton's auditing of Talidan's goodwill caused any harm or damage to Carnegie. Even if Carnegie had proven causation, the only evidence of economic damage it presented at trial related to the trading halt on April 30, 1999. As determined above, Carnegie did not inform the SEC of the possible triggering event related to Talidan until May 25, 1999. Accordingly, this issue could not have formed the basis for any conversation between the SEC and the AMEX that resulted in the trading halt.

B. Grant Thornton's Conduct Was Not the Proximate Cause of Carnegie's Alleged Damage

To establish the element of proximate cause, a plaintiff must introduce evidence establishing two elements: (i) cause in fact; and (ii) legally cognizable cause (or "legal cause"). See Board of County Comm'rs v. Bell Atlantic-Maryland, 346 Md. 160, 184 (1997); Peterson v. Underwood, 258 Md. 9, 16-17 (1970); Wankel v. A&B Contractors, Inc., 127 Md. App. 128, 158 (1999).

Cause in fact focuses upon whether the defendant's conduct actually was a cause of the plaintiff's alleged damages. Peterson, 238 Md. at 16-17. To satisfy this element, a plaintiff must establish a causal connection between the damages claimed and the defendant's conduct and show that "it is more probable than not that defendant's act caused his injury." Id. at 17. If there is no direct evidence of causation, causation may be established by circumstantial evidence if the evidence is sufficient to show "a reasonable likelihood or probability rather than a possibility." Id.; see also Med. Mut. Liab. Soc'y v. V.B. Dixon & Assocs., 339 Md. 41, 54-57 (1995).

In determining whether a cause in fact exists, one of two tests is employed, a "but for" test or a "substantial factor" test. See Wankel, 127 Md. App. at 158. The "but for" test applies "when the injury would not have occurred in the absence of the defendant's negligent act." Id. (citation omitted). The "substantial factor" test was created to address situations where "two independent causes concur to bring about an injury, and either cause, standing alone, would have wrought the identical harm." Id.

Carnegie urges that this Court find "that Grant's numerous and cumulative acts of accounting and auditing negligence in its SEC filings for Carnegie relating to treatment of the 'put feature liability' arising in the Russian transaction were the proximate and natural cause of the halt in Carnegie's common stock trading on April 30, 1999, one day after the stock was first listed for trading." Plaintiff's Proposed Findings at p.193. Even assuming that Grant Thornton was negligent in accounting for the Put Feature Liability, the evidence does not support a finding that the accounting for the Put Feature Liability was the cause of the trading halt.

When a Form 10-SB is filed, the SEC staff reviews the filing and provides comments. The SEC staff endeavors to provide comments before the Form 10-SB becomes effective. Management is responsible for providing responses to the comments. The company's attorneys and auditors assist management in providing those responses. Resolving the comments can be a time-consuming process. The SEC staff expects comprehensive responses to its comments and questions.

Carnegie's Form 10-SB became effective sixty days from the date of its filing, and Carnegie became a reporting company on December 28, 1998. The SEC staff provided comments on Carnegie's Form 10-SB in a comment letter dated December 30, 1998. That letter began a course of discussions between Carnegie and the SEC staff about Carnegie's submission.

The December 30, 1998 comment letter contained fifty separate comments on the Form 10-SB, including sixteen accounting comments. These included questions relating to the sale of the Talidan assets to Westshire, the PTT and Talidan purchase (and whether it constituted a reverse acquisition), and the sale of the stock of ECAC to Value Partners.

Carnegie responded to the comment letter on February 12, 1999, and it also filed an amended Form 10-SB/A the same day. In response to the accounting comments, Carnegie stated in its February 12, 1999 letter that it had revised the footnotes to its interim financial statements concerning the sale of Talidan's assets to Westshire and the ECAC transaction. Carnegie also argued that the purchase of PTT and Talidan was not a reverse acquisition.

Grant Thornton started the audit of Carnegie's December 31, 1998 financial statements in late February 1999. During the period the audit was being conducted, the SEC staff (i) continued to provide Carnegie with comments on Carnegie's responses to the December 30, 1998 comments on the Form 10-SB and (ii) provided additional comments on the Form 10-SB/A.

On March 29, 1999, the SEC staff forwarded additional accounting comments on the Form 10-SB/A. These comments questioned the recognition of gain on the Westshire and ECAC transactions and repeated the position that Carnegie's acquisition of PTT and Talidan should be accounted for as a reverse acquisition. The timing of the receipt of the comments from the SEC staff was significant. The March 29, 1999 communication from the SEC indicated that there were issues Carnegie had to address before it could file its Form 10-KSB. As a result of these comments, Carnegie missed the deadline for filing its Form 10-KSB, and Carnegie obtained an extension until April 15, 1999 to make that filing.

On April 1, 1999 Carnegie filed an application for listing on AMEX and qualified under the alternative criteria. The next day, April 2, 1999, Carnegie replied to the SEC staff's comments. In this reply, Carnegie provided a more detailed explanation of the ECAC transaction than it had previously and justified its position on the appropriateness of revenue recognition. Carnegie also explained the Westshire transaction and responded to the reverse acquisition comment.

On April 9, 1999, the SEC staff provided three additional comments on Carnegie's Form 10-SB/A. These comments all related to the reverse acquisition issue. On April 12, 1999, Carnegie responded to these comments. After reviewing this response, the SEC staff still had additional questions about the accounting for the acquisition of PTT and Talidan.

On April 15, 1999, the SEC staff raised two primary concerns with Carnegie's Form 10-SB/A. The staff, for the first time, questioned the eighty-five percent (85%) discount rate for the stock used to purchase PTT and Talidan. The staff continued to question whether the acquisition of those two companies should be accounted for as a reverse acquisition.

On April 19, 1999, Carnegie responded to the March 29 and April 9, 1999 comments. This response stated that the collectibility issues for ECAC and Westshire had been resolved through telephone conversations with the SEC staff. Carnegie also provided further information in support of its position that the acquisition of PTT and Talidan should not be accounted for as a reverse acquisition. The next day, Carnegie provided a supplement to the April 19, 1999 letter.

On April 20, 1999, at the request of Carnegie, Mike Starr, Grant Thornton's National Director of Assurance Services, became involved in the comment process, and shortly thereafter Starr had conversations with the SEC about the remaining open issues.

After a telephone conversation with the SEC staff, on April 21, 1999, Goldstein reported that the SEC staff had agreed that the PTT and Talidan acquisition did not have to be accounted for as a reverse acquisition. The discount issue, however, had not been resolved. Also on April 21, 1999, the SEC staff agreed not to challenge the use of a fifteen percent (15%) discount on the stock Carnegie issued to acquire PTT and Talidan. Carnegie then decided to acquiesce in the SEC staff's position in order to get the Form 10-KSB filed.

On April 27, 1999, Goldstein (now with Carnegie), in a conversation with Lisa Hackman of the AMEX, learned that the SEC staff had advised the AMEX that "there were open issues . . . surrounding" the filings that Carnegie had made with the SEC. Goldstein immediately wrote a letter to the SEC staff in which he stated that additional documentation to resolve those "open issues" would be included in the Form 10-KSB "which will be filed either this afternoon or first thing in the morning." Goldstein did not send this letter to Grant Thornton and he did not advise Grant Thornton that, according to Hackman, there were "open issues" that the SEC staff had raised.

Carnegie filed its Form 10-KSB on April 27, 1999. The AMEX notified the SEC on April 28, 1999 that it had approved Carnegie for listing on its exchange. The following day, April 29, 1999 Carnegie's stock started trading on the AMEX.

On April 29, 1999, Richard Wulff, Chief of the Office of Small Business of the SEC Division of Corporate Finance, wrote Carnegie in a comment letter about the Form 10-KSB which Carnegie filed on April 27, 1999. The April 29 comment letter addressed five items where "revisions need to made (sic) in an amended 10-KSB for the year ended December 31, 1998 and in an amended Form 10-SB." One of those five items involved the Put Option Liability on the Russian transaction. Also on April 29, 1999, the SEC notified the AMEX that it had concerns about Carnegie's filings.

From the facts set forth above, Carnegie wants this Court to conclude that the recognition of $3,107,564 in revenue in Carnegie's 1998 financial statement was the cause of the trading halt. This Court draws no such inference. The only testimony at trial regarding the cause of the AMEX's decision to halt trading in Carnegie's stock came from Perry Peregoy. He testified that the AMEX received a call from the SEC on April 29, 1999 regarding "some concerns." He did not testify as to what those concerns were or that they related to the Put Option Liability.

It is not reasonable to infer that the SEC's "concerns" were in fact primarily about the Russian transaction. As Carnegie's April 27, 1999 letter to the SEC staff shows, the SEC had various other concerns at the time, including concerns regarding: (i) the test of significance on ACC and RomNet, (ii) the purchase price allocation of PTT and Talidan, (iii) the update of the capital stock note to the financial statements for the undiscounted liability, and (iv) disclosure of a consulting agreement.

The history of communication between the SEC staff and Carnegie was extensive. There were multiple letters addressing multiple issues from the SEC staff to Carnegie. There were multiple responses from Carnegie. There were telephone calls from Carnegie to the SEC staff in which Grant Thornton did not participate and there was a call by Grant Thornton's Starr to the SEC staff without participation by anyone from Carnegie. The exchange of communications began prior to Carnegie applying for listing on the AMEX and continued after the trading halt.

All of this communication was occurring in an atmosphere of some urgency because of Carnegie's motivation to apply to the AMEX, be listed, and start trading. In light of these factors, and the lack of evidence of precisely what the SEC staff said to AMEX staff in the April 29, 1999 conversation, this Court does not conclude that the Put Option Liability was the cause or even a cause of the trading halt. It is just as likely that the SEC staff was unsettled by the accumulation of issues to be urgently resolved as it was concerned with any one transaction. It is simply an unknown. Carnegie failed to prove, by a preponderance of the evidence, what concern or concerns of the SEC staff motivated it to communicate with AMEX and what concern or concerns it expressed to AMEX.

Whether analyzed under the "but for" or "substantial factor" test, Carnegie's evidence has failed to prove the cause in fact of the trading halt on April 30, 1999. Accordingly, regardless of the theory of recovery, Carnegie has failed to prove causation.

V. <u>FLACH WAS NOT NEGLIGENT</u>

Carnegie has also brought a claim of negligence against Flach, individually. Carnegie claims that Flach's liability for his negligent acts, as a partner, flows from the Maryland Uniform Partnership Act (the "Act"). Pursuant to Section 9-307 of the Act, an individual partner can be held liable for any "negligent or wrongful act or omission of [that] partner . . . if [that] partner is negligent in appointing, directly supervising, or cooperating with the other partner, employee, or agent."

Flach was the Grant Thornton managing partner who, on February 1, 1999, appointed

Goldman as Carnegie's Audit Partner when Goldstein left Grant Thornton to join Carnegie as its CFO. It is the act of appointing Goldman to that position that Carnegie alleges was negligent. It also alleges that any liability for negligence by Grant Thornton is "imputed to and shared by" Flach. Complaint at ¶123.

Under either theory of liability, direct or shared, Carnegie has failed to meet its burden of proof. In discharging his responsibilities as Managing Partner of Grant Thornton's Baltimore office, Flach's conduct, including his assignment of Goldman as the Audit Partner for the audit of Carnegie's December 31, 1998 financial statements, conformed to that degree of care and skill that a reasonably competent accountant in a managerial position would have used under similar circumstances. Carnegie failed to prove that the appointment of Goldman as Audit Partner breached any standard of care.

Goldman had been the managing partner of the Baltimore office for twenty years and had been involved in a number of audits. Goldman had little SEC experience, but the Audit Partner is not charged with performing the audit himself. Krosin and others at Grant Thornton had knowledge of SEC reporting matters. Krosin had assumed primary responsibility for the SEC comments on Form 10-SB/A and served as the reviewing partner on the 1998 audit. There is no basis on which to conclude that Flach breached any duty to Carnegie by appointing Goldman as Audit Partner.

With respect to shared liability, Grant Thornton, as set forth above, complied with applicable professional standards in performing all of its services for Carnegie, and it used that degree of care and skill that a reasonably competent independent auditing firm would have used in similar circumstances. Therefore, Grant Thornton was not negligent and there is no negligent conduct to impute to Flach.

Finally, Carnegie has also failed to meet its burden to prove that Flach's conduct, or that of Grant Thornton, caused it damage.

VI. ***GRANT THORNTON MADE NO MISREPRESENTATION***

Under Maryland law, a party asserting a cause of action for fraudulent inducement must prove, by clear and convincing evidence, that: (1) the defendant asserted a false representation of material fact to the plaintiff; (2) the defendant knew that the representation was false, or the representation was made with such reckless disregard for the truth that knowledge of the falsity of the statement can be imputed to the defendant; (3) the defendant made the false representation for the purpose of defrauding the plaintiff; (4) the plaintiff relied with justification upon the misrepresentation; and (5) the plaintiff suffered damages as a direct result of the reliance upon the misrepresentation. See Maryland Envtl. Trust v. Gaynor, 370 Md. 89, 97 (2002); Sass v. Andrew, 152 Md. App. 406, 429 (2003); Phillip Morris, Inc. v. Angeletti, 358 Md. 689, 725 (2000).

Carnegie claims Grant Thornton falsely induced it to hire Grant Thornton as its auditor by misrepresenting the experience and abilities of its auditors, by quoting a fee of twenty thousand dollars ($20,000) for the 1997 audit, and by failing to disclose the personal history of Goldstein.

Carnegie interviewed Grant Thornton in late November or early December 1997. Carnegie intended to hire an accounting firm to audit Carnegie's consolidated financial statement for the year ending December 31, 1997 and to assist Carnegie in preparing public filings with the SEC related to Carnegie's quest to become a reporting publicly traded company. Carnegie also interviewed two other accounting firms, Arthur Andersen and KPMG. At the time Carnegie interviewed Grant Thornton, Grant Thornton knew that Carnegie's then current auditing firm, Resnick Fedder & Silverman, had little or no SEC experience. At the time, Goldman was Grant Thornton's managing partner in the Baltimore office. He and Goldstein, the Grant Thornton partner selected to be the initial Audit Partner, were the Grant Thornton employees who interacted with Carnegie as a possible client. During the initial meeting, Grant Thornton informed Carnegie it could handle complex journal entries and the auditing of

Carnegie's financial statements, and it could assist Carnegie with the filing of its registration statement with the SEC. Grant Thornton represented to Carnegie that Grant Thornton was competent in public company auditing.

Goldman and Goldstein further represented to Carnegie that Grant Thornton 1) was experienced in public company audits, 2) had staff experience and was knowledgeable about SEC accounting and auditing issues, procedures, and reporting functions, and 3) possessed a network of offices to assist Grant Thornton's Baltimore office in auditing Carnegie's international subsidiaries.

Carnegie did not prove by clear and convincing evidence that Grant Thornton made any misrepresentation to it. First, there was no credible evidence that any of the affirmative representations made to Carnegie regarding the abilities and experience of Grant Thornton staff were untrue. Grant Thornton had staff with SEC experience, including Goldstein who had been involved in the auditing of four or five SEC reporting companies. It had national and international offices. The New York office, including Graziano and Illiano, were brought into the Carnegie audits as necessary. Starr, also from the New York office, was brought in to interact with the SEC staff after Carnegie had applied to the AMEX and the SEC continued commenting on Carnegie's reports.

Grant Thornton also represented to Carnegie that Carnegie would be assigned a partner experienced in SEC matters and with national support. Goldstein, the initial Audit Partner, was represented as a Grant Thornton auditor with SEC experience and as set forth above, he had such experience.[5]

With its frequent use of superlative adjectives, see pp 2-5 of Plaintiff's Proposed Findings, Carnegie urges this Court to make findings that Grant Thornton represented that it

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[5] Although Goldman, who had little SEC experience, later became Audit Partner, this was not a matter known to Grant Thornton, nor could it have been known to Grant Thornton at the time of engagement. Goldman did not become Audit Partner until Carnegie hired Goldstein in February, 1999. Accordingly, the representation that Carnegie would be assigned an Audit Partner with SEC experience was not false when made.

had superior expertise. There is no credible evidence of that. Specifically, the Court does not find the testimony of Gable or Farkas credible. There is no credible evidence that Grant Thornton misrepresented its competence, expertise or integrity.

Carnegie also did not prove by clear and convincing evidence that Grant Thornton made any material omission. Prior to the engagement, Grant Thornton did not disclose to Carnegie that Goldstein, the Audit Partner assigned to Carnegie, had had psychiatric treatment and a history of alcohol abuse. There was no evidence, however, from which this Court could find that any such issue was material. Nothing in Goldstein's personal history was shown to have been the source of any error by Grant Thornton or the cause of any harm to Carnegie. Nor was there credible evidence that Carnegie would have hired an auditing firm other than Grant Thornton, if it had known of Goldstein's history.[6]

VII. <u>GRANT THORNTON BREACHED NO ALLEGED RELATIONSHIP OF TRUST</u>

Carnegie asserts that a special relationship of trust and confidence existed between it and Grant Thornton because Grant Thornton asserted to Carnegie that Grant Thornton had superior knowledge and expertise in accounting matters upon which Carnegie should rely. "As a result, a special relationship of trust and confidence was created between Carnegie and Grant based upon Grant's representations of superior knowledge." Plaintiff's Proposed Findings at p.149.

Carnegie claims Grant Thornton breached its fiduciary duty by: 1) failing to adequately perform services; 2) continuing its relationship with Carnegie after it knew or should have known that it was no longer independent and; 3) by undertaking efforts designed to injure Carnegie after it became apparent that Grant Thornton had failed to comply with its professional

[6] The materiality of this information to Carnegie is also belied by the fact that Carnegie hired Goldstein in February, 1999. Carnegie hired Goldstein while he was employed with Grant Thornton and after he had performed substantial work on Carnegie's account. At the time Carnegie hired Goldstein, he was the Audit Partner for Carnegie. If his conduct was unsatisfactory, Carnegie would, presumably, have hired someone else to serve in the significant position of CFO at Carnegie.

obligations and the standard of fiduciary duty. Carnegie further claims that Grant Thornton failed to disclose and later correct accounting irregularities, errors, and misstatements in Carnegie's consolidated financial statements.

Carnegie cannot recover under a claim of breach of trust. Maryland law does not recognize a "universal or omnibus tort for the redress of breach of fiduciary duty" in a situation where other remedies at law exist. Kann v. Kann, 344 Md. 689, 713 (1977); Swedish Civil Aviation Admin. v. Project Mgmt. Enter., Inc., 190 F. Supp. 2d 785, 801 (D. Md. 2002) (stating that "breach of fiduciary duty would continue to be a part of other causes of action. Accordingly, there is no independent tort for breach of fiduciary duty in Maryland, especially in light of the multiple alternative remedies" already available); Kerby v. Mortgage Funding Corp., 992 F. Supp. 787, 803 (D. Md. 1998) (quoting Kann and dismissing a claim for breach of fiduciary duty, because "Maryland recognizes no 'universal or omnibus tort for the redress of breach of fiduciary duty,' at least in a situation where other remedies exist . . ."). In Lerner Corp. v. Three Winthrop Props., Inc., 124 Md. App. 679, 692 n.4 (1999), the Court of Special Appeals cited to Kann for the proposition, without qualification, that "Maryland law does not recognize an independent, omnibus cause of action in tort for breach of fiduciary duty."

Carnegie's claim for breach of trust and claim for negligence are based on the same allegations and the same operative facts and are claimed to have resulted in the same alleged injuries to Carnegie. Thus, Carnegie's breach of trust claim is duplicative of its negligence claim and does not state an independent cause of action. This Court concludes that, as a matter of law, Carnegie cannot recover any damages under a theory of breach of trust.

Even if the Court were to recognize a cause of action for breach of fiduciary duty under the circumstances presented here, the facts do not bear out such a special relationship. The relationship between Grant Thornton and Carnegie was one of independent auditor and client. As determined by this Court supra at 38-39, Grant Thornton did not hold itself out to have specialized expertise or otherwise act to create any relationship with Carnegie other than auditor and client. Grant Thornton did not owe any duties to Carnegie other than those duties arising out of that relationship. For this reason also, Carnegie cannot recover on any theory of breach of fiduciary duty.

Finally, even if Carnegie could proceed on this theory, and even if there were a special or fiduciary relationship, Grant Thornton did not breach it. As determined previously, Grant Thornton complied with applicable professional standards in performing all of its services for Carnegie, and it used that degree or care and skill that a reasonably competent independent auditing firm would use in similar circumstances. Also as determined herein, infra at 46 - 49 Carnegie's hire of Goldstein as its CFO in February, 1999, did not cause a loss of Grant Thornton's independence nor did it result in an appearance of the loss of independence.[7] Accordingly, even if there was a special relationship between Carnegie and Grant Thornton, there was no breach of trust.

VIII. GRANT THORNTON'S FEES WERE NOT EXCESSIVE

Count V of Carnegie's Complaint claims Grant Thornton charged it excessive fees. It demands the return of those fees and for an accounting. Complaint at ¶ 112. Although never withdrawn, Carnegie effectively abandoned this claim. It proposed no findings of fact or conclusions of law on this claim. It referenced Grant Thornton's fees only as evidence of Grant Thornton's fraudulent inducement of Carnegie and Grant Thornton's alleged inexperience in SEC matters.

In the event the claim has not been abandoned, the Court finds there is insufficient evidence from which the Court could make a finding that the fees charged by Grant Thornton were excessive. Witnesses described the budget for the audit of the December 31, 1997,

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[7] Although the SEC commented on the independence question, it dropped that line of inquiry. More important, however, is the timing. The SEC did not make this comment until its correspondence dated May 27, 1999, which was a month after the trading halt.

financial statements and the approximate total fees for the work. Carnegie, however, failed to introduce any evidence, including expert testimony, that the fees did not conform to those charged by other auditing firms in the Baltimore area for the type and amount of work actually performed by Grant Thornton. The Court therefore concludes that Carnegie failed to prove, by a preponderance of the evidence, that it is entitled to any recovery for overpayments or for an accounting.

IX. GRANT THORNTON DID NOT INTERFERE WITH CARNEGIE'S BUSINESS RELATIONS

Carnegie claims that Grant Thornton committed several acts constituting tortious interference with business relations. Carnegie claims that Grant Thornton: 1) shifted the blame for the trading halt away from it and onto Carnegie; 2) demanded that a third party provide it with information concerning the consideration in the Westshire deal; 3) refused to cooperate with Carnegie's new auditors; 4) refused to allow Carnegie to use its 1997 audit results; and 5) filed a defamatory response to Carnegie's 8K filing.

To prove an action for tortious interference with an existing contractual relationship, a party must establish (i) the existence of a contract between a plaintiff and a third party, (ii) defendant's knowledge of that contract, (iii) the defendant's intentional inducement of the third party to breach the contract, (iv) that the defendant acted without justification, (v) the subsequent breach by the third party, and (vi) damages resulting therefrom. See e.g., Bagwell v. Peninsula Reg'l Med. Ctr., 106 Md. App. 470, 503 (1995) (citations omitted).

Under Maryland law, a party asserting a cause of action for tortious interference with existing or prospective business relations must prove, by a preponderance of the evidence, that (i) the defendant committed intentional and willful acts, (ii) the acts were calculated to cause damage to the plaintiff in its lawful business, (iii) the acts were done with the unlawful purpose to cause such damage and loss, without right or justifiable cause (which constitutes malice), and (iv) actual damage and loss. See, e.g., Volcjak v. Washington County Hosp. Ass'n, 124 Md. App. 481, 512 (1999) (citations omitted); see also Lyon, 120 Md. App. at 431 (citations omitted); Bagwell, 106 Md. App. at 504 (citations omitted).

Both an improper act and an improper motive are necessary to establish a claim of interference with business relations. See Macklin v. Robert Logan Assocs., 334 Md. 287, 300-301 (1994); Volcjak, 124 Md. App. at 512. An improper act is defined as "'violence or intimidation, defamation, injurious falsehood, or other fraud, violation of the criminal law, and the institution or threat of groundless civil suits or criminal prosecutions in bad faith.'" See K&K Management, Inc. v. Lee, 316 Md. 137, 166 (1989).

A breach of contract is not a "wrongful act." Thus, if the defendant's act was nothing more than a breach of contract, which incidentally interfered with plaintiff's business relations, a cause of action for tortious interference will not lie. See Macklin, 334 Md. at 302; see also Alexander & Alexander, Inc. v. B. Dixon Evander & Assocs., 336 Md. 635, 654, (1994) (citing K&K Management, 316 Md. at 169 ("[T]his Court has refused to adopt any theory of tortious interference with contract or with economic relations that 'converts a breach of contract into an intentional tort.'")).

A. Grant Thornton Did Not Attempt to Shift Blame to Carnegie

Carnegie claims that one of the tortious and malicious acts Grant Thornton committed was to shift the blame for the trading halt away from Grant Thornton and to place the blame on Carnegie. "Specifically, Grant shifted the blame by dispatching Mike Starr to Carnegie immediately following the trading halt. Mr. Starr was one of Grant's most senior audit partners and a member of Grant's senior management. Mr. Starr was sent to Carnegie under the guise that he was going to repair Grant's mess and right the wrongs committed by Grant." Plaintiff's Proposed Findings at p.163 - 64.

Other than the self-serving, incredible testimony of Gable, there was no evidence to support the proposition that Starr was sent to injure Carnegie and protect Grant Thornton.

Initially, it must be mentioned that Starr was involved in the Carnegie audits prior to April 30, 1999, so it cannot be credibly stated that he was brought in solely for damage control after the trading halt. Moreover, Starr was a senior manager at Grant Thornton and his dispatch to Carnegie was an example of exactly the type of assistance from Grant Thornton's national offices that Grant Thornton promised to deliver when Carnegie hired Grant Thornton Accordingly, there was no improper act in the dispatch of Starr to assist in Carnegie's audits or communications with the SEC. Additionally, no improper motive was proven.

B. Grant Thornton's Inquiry Into Westshire Was Appropriate

Carnegie claims that Grant Thornton committed tortious interference when, in connection with investigating the circumstances concerning Westshire becoming a shareholder, Grant Thornton had a conversation with Westshire's counsel. Carnegie alleges that Grant Thornton informed Westshire that, if certain information was not provided, Carnegie would be adversely affected.

No credible evidence supports Carnegie's theory that Grant Thornton's contact with Westshire was undertaken with an intent to induce Westshire to breach its contract. To the contrary, as Ten Eyck and others testified, professional standards required the auditors to make the inquiry of Westshire. Furthermore, Carnegie presented no evidence that Grant Thornton threatened Westshire or made any statements which could be understood to intentionally induce Westshire to breach its contract. The credible evidence established that Carnegie, not Grant Thornton, directed Westshire's actions. Westshire was a company controlled by Pearl and Gershberg. The credible evidence established that Carnegie never intended for Westshire to repay its debt to Carnegie other than by selling Carnegie stock. Accordingly, Grant Thornton's conduct was neither wrongful nor determinative of Westshire's conduct.

C. Grant Thornton Did Not Refuse to Assist Carnegie

Carnegie also alleged that Grant Thornton refused to assist Carnegie in correcting the mistakes in Carnegie's financial statements, that its motivation for this conduct was to protect itself from potential liability, and that such conduct caused the destruction of Carnegie's business relations with third parties. The credible evidence introduced at trial establishes that Grant Thornton did not refuse to assist Carnegie; rather, throughout the entire SEC comment process and the period following the trading halt, Grant Thornton continued to assist Carnegie in resolving the SEC's questions. It was only after the auditors discovered in August, 1999, that Carnegie's management had failed to provide complete and accurate information that Grant Thornton pressed for more information and ultimately concluded that they could no longer rely upon the representations of Carnegie's management. Such conduct by Grant Thornton was fully consistent with its professional obligations and did not, therefore, form the basis of any alleged tort.

Carnegie also argues that Grant Thornton tortiously 1) withheld its work papers from Carnegie's new auditors, 2) refused Carnegie the use of its 1997 audit results, and 3) filed a letter with the SEC regarding Carnegie's 8K filing.

On or about September 23, 1999, Carnegie advised Grant Thornton that it was terminating Grant Thornton. In accordance with Federal law, Carnegie advised the SEC that it was changing auditors on or about September 28, 1999. Prior to that filing, Carnegie sent to Grant Thornton a draft Form 8-K of the proposed filing. That draft did not 1) disclose Grant Thornton's statement to Carnegie that it could no longer rely on the representations of its management and 2) did not disclose that there would be a scope limitation on any opinion issued by Grant Thornton. For these reasons, Grant Thornton sent Carnegie a letter on September 24, 1999, advising that it did not agree with the proposed Form 8-K. Carnegie included that September 24, 1999 letter in its Form 8-K that it filed with the SEC, but it also included additional explanations for its discharge of Grant Thornton. In accordance with its professional obligations, Grant Thornton was then required to, and did, write to the SEC advising it of its position on Carnegie's explanation. Grant Thornton did so in a letter to the SEC dated October 11, 1999. Carnegie was required to, and did, amend its Form 8-K to include

Grant Thornton's October 11, 1999, letter.

Once Grant Thornton learned that it could not rely on the representations of Carnegie's management, it had a professional responsibility to limit the use of possibly unreliable information. Grant Thornton's letter to the SEC identified six reasons why it disagreed with the information reported by Carnegie. Carnegie failed to prove, by a preponderance of the evidence, that any of that information Grant Thornton provided to the SEC was inaccurate or that the disclosure to the SEC was motivated by anything other than Grant Thornton's professional responsibility.

Carnegie presented no evidence that would support a finding that Grant Thornton acted with the purpose of inducing third parties to either breach their existing relations with Carnegie or to refrain from entering into a prospective relationship with Carnegie. The credible evidence was that Grant Thornton adhered to its professional obligations. There was no credible evidence that Grant Thornton induced a third party to breach its contract with Carnegie, that Grant Thornton engaged in any alleged wrongful act without justification or that Carnegie suffered any damage as a result of any alleged tortious interference with an existing contractual relationship.

Similarly, there is also no credible evidence that Grant Thornton committed any acts calculated to cause damage to Carnegie's business, or that its acts were unjustified or caused damage to Carnegie. To the contrary, Grant Thornton acted as a responsible independent auditor of a company with continuing aspirations to be publicly traded.

The Court therefore concludes that Carnegie failed to prove, by a preponderance of the evidence, that Grant Thornton interfered with any contract or business relationship, existing or prospective, of Carnegie.

X. GOLDSTEIN WAS INDEPENDENT OF GRANT THORNTON FOR THE 1998 AUDIT

The AICPA and SEC independence rules require that an audit firm be independent of the company whose financial statements it is auditing. Goldstein moved from Grant Thornton to Carnegie in February, 1999. In order for Grant Thornton to be independent for the 1998 audit, Goldstein could not have performed any work on the audit of Carnegie's December 31, 1998 financial statements. Also, Goldstein could not be in a position where he would receive any compensation from Grant Thornton relating to that audit.

Beginning on January 18, 1999, Farkas, Carnegie's President, had discussions with Goldstein regarding his potential employment with Carnegie. Goldstein initially did not believe that Carnegie would be able to put together a sufficient compensation package; therefore, Goldstein did not take the initial discussions of a job with Carnegie seriously.

Goldstein explained to Gable and Farkas the potential implications of any formal offer of employment to him. Carnegie did not disclose these initial discussions to Grant Thornton. Goldstein did not disclose these initial discussions to others at Grant Thornton.

On January 31, 1999, Goldstein accepted employment with Carnegie as Carnegie's CFO. On February 1, 1999, Goldstein informed Flach as Managing Partner of the Baltimore office, that he had accepted Carnegie's offer of employment and that he was resigning from Grant Thornton. Flach contacted Dick Stewart at Grant Thornton's National Office who advised Flach about the proper procedures to be followed.

The credible testimony by those persons in a position to know – Goldstein and Krosin – was that when Goldstein announced he had accepted employment with Carnegie, Grant Thornton had not started the 1998 audit and Goldstein had not performed any work on the 1998 audit.

Thereafter, on February 4, 1999, the National Office of Grant Thornton made preparations to sever all financial ties with Goldstein. On February 12, 1999, Lou Fanchi of Grant Thornton's National Office informed Flach that Grant Thornton's management committee had approved a final payout to Goldstein.

Krosin prepared a memorandum, dated February 26, 1999 which he supplemented in June, 1999. In the memorandum, he set forth the steps Grant Thornton took to preserve its independence. In his memorandum, Krosin concluded that: (i) the audit of Carnegie's December 31, 1997 financial statements, for which Goldstein had acted as the engagement partner, had been reviewed on several levels; (ii) Goldstein had not been involved with planning the 1998 audit; and (iii) the time billed by Goldstein on Carnegie matters, from January 18, 1999 until February 15, 1999, did not relate to the 1998 audit. Krosin therefore determined that Grant Thornton's independence was not impaired by Carnegie's employment of Goldstein.

On April 27, 1999, Carnegie filed its Form 10-KSB with the SEC. In a comment letter dated May 27, 1999 (almost 30 days after the trading halt), the SEC raised the issue of Grant Thornton's independence for the first time. Upon receipt of that comment, Starr explained the issue to Carnegie's audit committee.

Additionally, Thomas Rafter, Grant Thornton's Assistant General Counsel, conducted an investigation. Rafter examined time records and Goldstein's computer files to determine whether Goldstein had performed any work on the 1998 audit. Rafter worked with the Audit Committee on this issue. On June 15, 1999, Rafter conducted an interview with Goldstein, attended by a representative of Carnegie (Pearl), Goldstein, Goldstein's independent counsel (Steve Fedder), Carnegie's audit committee and additional Grant Thornton representatives. At that meeting, Rafter questioned Goldstein extensively regarding his documents and work on Carnegie matters after January 18, 1999.

On June 23, 1999, in a conference call with the audit committee, Starr stated that he believed Grant Thornton to be independent. Carnegie provided the SEC staff with a written response on the independence issue on July 2, 1999 and discussed the issue with the SEC on July 12, 1999. In response to the SEC's questions raised on July 12, 1999, Grant Thornton sent a letter to the SEC staff on July 16, 1999. [8] In this letter, Grant Thornton provided the SEC staff with a detailed explanation of Goldstein's activities.

On August 5, 1999, the SEC staff wrote to Carnegie and requested a letter from Carnegie (the "Tandy" or "no comfort" letter) 1) acknowledging Carnegie's responsibility to have independent auditors and 2) requiring Carnegie to agree that the SEC's forbearance on the independence issue could not be asserted as a defense to any later action by the SEC. Carnegie did not send the requested letter, but the SEC made no further inquiry regarding Grant Thornton's independence and took no further action. The only credible inference to be raised by the SEC action is that the independence issue had been cleared and that the matter was closed. The independence issue did not delay the issuance of the Carnegie's December 31, 1998 financial statements or any amendments to those financial statements.

Carnegie offered no convincing expert testimony that Goldstein's hire impaired Grant Thornton's independence. Dr. Barton opined only that Grant Thornton may not have appeared independent. That qualified opinion, even if accepted, is insufficient to find that Grant Thornton was negligent in conducting the December 31, 1998 audit. Grant Thornton did not breach any duty owed to Carnegie when Grant Thornton continued to serve as Carnegie's independent auditor after Carnegie hired Goldstein.

Grant Thornton was independent. However, even if it had not been, the independence issue was not raised by the SEC until after August, 1999, which was more than 60 days after the trading halt. Because the only evidence of economic harm was related to the trading halt, even if Carnegie had proven that Grant Thornton lacked independence, Carnegie failed to prove that lack of independence was the cause of any harm to Carnegie.

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[8]At this time, (mid July, 1999) communications between Carnegie and Grant Thornton were limited because Carnegie had hired a law firm to represent it relating to any claims it might have against Grant Thornton.

XI. GRANT THORNTON PROVED AFFIRMATIVE DEFENSES TO CARNEGIE'S CLAIMS

A. Carnegie's Claims Are Barred By the Doctrine of In Pari Delicto

Through its officers, directors, and other agents and representatives, Carnegie intentionally attempted to engage in financial reporting fraud and caused false financial statements to be filed with the SEC.[9] Plaintiffs' claims in this case are related to or connected to the attempted fraud and are, therefore, barred by the doctrine of in pari delicto.

The maxim in pari delixcto, potior est conditio defendantis, is a corollary of the clean-hands doctrine. It means that where the wrong of one party equals that of the other, the court will leave the parties where it found them, effectively placing the defendant in the favored position. Relief will be denied, at law and in equity, where the parties are shown to have been in pari delicto or to have acted with the same degree of knowledge as to the illegality of their actions. To apply the maxim, the illegal acts must have been entered into voluntarily and the turpitude of the parties must have been mutual.

The doctrine has aptly been described as follows:

> The basis of this rule is that the law will not lend its aid to a transaction in violation of law, and particularly to a participant. In Haller v. Workingmen's Co-op. Bank, 263 Mass. 37, 160 N.E. 324, it is said: 'The well settled principle of law is, that no one knowingly participating in a transaction intended to accomplish a purpose forbidden by law can bring an action for any cause directly connected with that Illegality.'

Brinley v. Williams, 189 Okla. 183, 114 P.2d 463, 464-65 (1941) (additional citations omitted).

In applying the in pari delicto doctrine, the courts do not automatically condone the defendant's infraction because the plaintiff is also blameworthy, thereby leaving two wrongs with no remedy. Instead, the courts weigh the relative extent of each party's wrong such that an equitable balance can be made. However, the courts will not generally balance the equities in a

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[9] Gable and Farkas knew that federal securities laws, and the rules and regulations of the SEC, imposed additional obligations on Carnegie's management to ensure that information that was disseminated to the investing public was accurate, complete, and not misleading.

case where a party's wrongful conduct has been willful. United States EPA. v. Environmental Waste Control, Inc., 917 F.2d 327 (7th Cir. 1990), cert denied, 499 U.S. 975 (1991); cf. Schneider v. Schneider, 335 Md. 500 (1994).

Under Maryland law a party may not recover damages from another party where it has engaged in fraudulent or wrongful conduct and its claim arises out of or is connected to that conduct.[10] "When plaintiff and defendant have participated in fraudulent or illegal conduct, contrary to law or public policy or in fraud of the law itself and are in pari delicto, plaintiff cannot maintain suit – at law or in equity – directly arising out of the misconduct." Messick v.Smith, 193 Md. 659, 669 (1949) (citation omitted). Cf. Schneider v. Schneider, 335 Md. 500, 508-11 (1994) (When parties are mutually at fault the doctrine of in pari delicto requires the court to leave the parties as the court finds them in order to deter such future fraudulent conduct. Plaintiff not barred where application of in pari delicto would not effectively discourage perjury in divorce proceeding). See also Hicks v. Gilbert, 135 Md. App. 394, 400-402 (2000) (plaintiff's "unclean hands" bar claims for contribution resulting from fraudulent property transfer); State v. Strickland, 42 Md. App. 357, 362 (1979) (plaintiff not entitled to return of money used for bribe: "[p]arties of that ilk are left where they are found, to stew in their own juice."); Certa v. Wittman, 35 Md. App. 364, 370 (1977) ("The law will not aid a man who founds his cause of action upon his own illegal acts."); Zalis v. Blumenthal, 254 Md. 265, 267 (1969) (plaintiff who violates the law cannot recover); Thorpe v. Carte, 252 Md. 523, 529 (1969) (plaintiff who violates a statute cannot recover); Shirks Motor Express Corp. v. Forster Transfer & Rigging, 214 Md. 18, 29-30 (1957) (where plaintiff is party to an illegal contract in violation of the law, the doctrine of in pari delicto bars his claims). The in pari delicto doctrine reflects a strong public policy that courts should not aid a wrongdoer. See, e.g., State v. Stickland, 42 Md. App. 317 (1979); Thorpe v. Carte, 252 Md. 523, 529 (1969).

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[10] The Maryland courts have not consistently cited the doctrine of in pari delicto, but they have applied the principle.

Although no Maryland court has applied the in pari delicto doctrine under facts similar to those at issue here, other courts have barred claims against an accountant by a corporation where the corporation's officers and directors engaged in fraudulent conduct giving rise to or related to the corporation's claims. The Seventh Circuit approved of a trial court permitting the jury to consider fraudulent acts of the plaintiff corporation's top management as defenses to claims that auditors failed to discover and disclose fraud, where the corporation's managers inflated inventory figures. Cenco, Inc. v. Seidman & Seidman, 686 F.2d 449 (7^{th} Cir. 1982) (Posner, J.).

Similarly, in Mid-Continent Paper Converters, Inc. v. Brady, Ware & Schoenfeld, Inc., 715 N.E. 2d 906 (Ind. App., 1999) a corporation's malpractice claim against its accounting firm was barred. The corporation brought the claim for the accountants' alleged failure to discover the misrepresentations and falsifications of financial data by the corporation's chief financial officer. The court held that the corporation could not recover where the CFO was the corporation's designee charged with assisting the accounting firm with the audits and he had committed independent acts of fraud against the accounting firm. He had signed false representation letters on which the accountants relied. See also Official Comm. Of Unsecured Creditors v. Coopers & Lybrand, LLP, 322 F. 3d 147, 163-64 (2d Cir. 2003) ("[W]e agree with the District Court that [plaintiff, accounting client], through its Board and controlling shareholders, bore "at least substantially equal responsibility with Coopers for permitting [the transaction] to go forward on the basis of inflated projections."); Seidman & Seidman v. Gee, 625 So. 2d 1, 3 (Fla. Dist. Ct. App. 1992) (ordering entry of judgment for accounting firm where corporation's controller had engaged in fraud), review granted, 640 So.2d 1106 (Fla. 1994), cause dismissed, 653 So.2d 384 (Fla. 1995); Grove v. Sutliffe, 916 S.W.2d 825, 830 (Mo. App. 1995) (barred corporation's claim against accountants); Miller v. Ernst & Young, 938 S.W.2d 313, 316 (Mo. App. 1997) (entering summary judgment in favor of accountants where corporate officer engaged in fraud).

The doctrine of in pari delicto has also been widely invoked to defeat the claims of professional malpractice claims brought against attorneys. See, e.g., In re Dublin Sec., Inc., 133 F.3d 377 (6th Cir. 1997); Tillman v. Shofner, 90 P.3d 582 (Okla. Civ. App. Div. 1, 2004); Mrozek v. Intra Fin. Corp., 678 N.W.2d 264 (Wis. App., 2004); Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co., Inc., 267 F.3d 340, 358-60 (3d Cir. 2001) (finding that where corporation's officers and directors engaged in fraud, fraud is imputed to corporation and corporation cannot recover under doctrine of in pari delicto).

Carnegie's management, representatives, and agents were aware of their duty to prepare accurate financial statements and cooperate with Grant Thornton to that end. As set forth below and elsewhere herein, Gable, Farkas, Pearl and Gershberg, made or caused intentional misstatements or omissions of amounts or disclosures in the 1998 financial statements, including in the December 31, 1998 audited financial statements filed with Carnegie's Form 10-KSB. Carnegie's management repeatedly withheld material information and/or provided inaccurate information to Grant Thornton. Carnegie's officers' explanations for their conduct are not credible. Accordingly, this Court finds that Carnegie's management was engaged in attempted fraud and other wrongdoing which deceived Grant Thornton and possibly others.

The intentional misstatements or omissions by Carnegie's management and agents resulted from, inter alia, Carnegie's 1) failure to disclose its affiliation and transaction with those affiliates and 2) inaccurate reporting of four transactions during 1998: the sale of ECAC (Europe) to Alpina Tours; the sale of ECAC to Value Partners; the sale of certain Talidan assets to Westshire; and the sale of rights to distribute MAVIS in Russia. In each of these four transactions, Carnegie's management, representatives, and agents manipulated, falsified, or altered accounting records and supporting documents; misrepresented events, transactions, or other significant matters, including the dates on which such transactions purportedly occurred; and intentionally misapplied accounting principles.

1. Carnegie Failed to Disclose Affiliations

Prior to becoming employed by Carnegie, Gable was associated with DAR Products from approximately 1993 to 1996. The shareholders or beneficial owners of DAR Products were Gable, Pearl, Gershberg, Caruthers and Lashra (collectively, "DAR Products Shareholders").[11] As part of the Exchange Agreement pursuant to which Carnegie acquired ECAC and DAR Products, the shares of Carnegie stock were to be divided among the former owners of ECAC and DAR Products. As a result, 6,000,000 shares of Carnegie stock were issued to the DAR Products Shareholders. An additional 3,130,999 shares of Carnegie stock were issued in the name of Gable.

Preferred Investments, Ltd. ("Preferred") was a company used to hold Carnegie stock offshore for the DAR Products shareholders. Preferred was part of The Lashra Trust, an offshore trust. Lashra was the beneficiary of this trust. Other companies that were part of The Lashra Trust included CNI, S.A., Westshire and Treasure Bay. After Gable became CEO of Carnegie, Carnegie's board of directors resolved that several million shares of Carnegie stock be issued to E. David Gable & Associates (The partners of E. David Gable & Associates were Gable, Pearl, Gershberg, Caruthers and Lashra.), Preferred and other companies controlled by Carnegie or one or more of its officers, including Pearl.

The substantial number of shares owned beneficially by Gable, Pearl and Gershberg created a motive for these individuals to overstate Carnegie's financial condition and its results

[11] Pearl was Carnegie's Secretary. Prior to becoming employed by Carnegie as its Secretary, Pearl practiced law with Richard Gershberg in the firm of Gershberg and Pearl. Gershberg and Pearl served as Carnegie's General Counsel. After Pearl terminated his association with Gershberg effective June 30, 1996, Gershberg's firm, Gershberg and Associates, served as Carnegie's General Counsel from September 1996 until approximately December 1999. The types of services provided by Gershberg and Pearl and Gershberg and Associates to Carnegie included: the handling of most transactions; the preparation of letters of intent; the preparation of due diligence check lists; and the preparation of definitive agreements. Gershberg's principal contacts at Carnegie were Gable as its CEO, Farkas as its President and Pearl as its Secretary. Gable and Farkas delegated to Pearl several functions relating to the conduct of Carnegie's business. Pearl's activities were authorized by, and conducted for the benefit of, Carnegie. All such activities were conducted within the scope of Pearl's employment or agency for Carnegie.

of operations. These individuals stood to benefit significantly from the listing of Carnegie's stock on a national securities exchange and from any increase in the share price of Carnegie stock.

In October 1996, Gable, Pearl, Gershberg, Caruthers and Lashra met to decide on how to allocate the assets of various companies and entities in which they had or claimed an interest, including DAR Products, E. David Gable & Associates, and Strongput International ("Strongput"). These assets included the shares of Carnegie stock that had been issued to the DAR Products shareholders in the names of Preferred, CNI and E. David Gable & Associates and in the names of other companies. This group agreed to the following allocation of interests in those assets, including the shares of Carnegie stock: fifty percent (50%) or fifty-one percent (51%) to Caruthers and Lashra; thirty percent (30%) or thirty-one percent (31%) to Gable; and nine percent (9%) or ten percent (10%) each to Pearl and Gershberg. This group owned approximately 10,000,000 shares of Carnegie stock. Gable claimed a beneficial interest in 2,800,000 to 2,900,000 of these shares.

Strongput was formed by Pearl with Gable's knowledge. It was formed so Carnegie could issue stock to the company that would then be sold to raise money for Carnegie's operations. Pearl formed several other companies for this purpose, including Sixteen Six, Inc. Carnegie controlled the activities of Sixteen Six and Strongput.

From time to time after October 1996, shares of Carnegie stock titled in the name of Preferred, CNI or other offshore companies were sold and the proceeds from such sales were distributed to the group. Pearl and Gershberg directed the sales of Carnegie stock held by the offshore companies. Because its subsidiaries' operations did not generate sufficient cash flows to meet the consolidated operations' requirements, Carnegie "borrowed" stock and money from Preferred, CNI and other offshore companies. Under the direction of Gable, Pearl arranged for these borrowings for Carnegie. Carnegie thus benefitted from the shares issued to the offshore companies and to Strongput.

Neither the October 1996 sharing arrangement nor the affiliation of the various offshore companies and the other companies (including Sixteen Six and Strongput) were disclosed to Grant Thornton.

2. Carnegie Falsified Documentation on Sale of Stock of ECAC (Europe) to Alpina Tours.

Carnegie reported in its Form 10-SB that it sold its subsidiary, ECAC (Europe), to Alpina Tours, on January 6, 1998, for a $250,000 promissory note from Alpina Tours. Carnegie recognized a $250,000 gain on this transaction. This sale did not occur on January 6, 1998. Instead, Carnegie's management and agents backdated the documentation to make it appear that the sale had occurred on January 6, 1998. The draft agreement was not prepared until August, 1998. The final agreement was not executed until September 1998 and Carnegie did not own the ECAC stock until August, 1998. Carnegie's management knew that this sale of ECAC (Europe) did not take place on January 6, 1998. Carnegie's management should not have reported it as having occurred on January 6, 1998. It should not have reported it as having occurred during the year-ending December 31, 1998 and Carnegie should not have reported a $250,000 gain on the sale of this business.

At the time of the filing of Carnegie's Form 10-SB, Grant Thornton was not aware of the backdating of documentation on this sale.

3. Carnegie Misrepresented the Sale of Stock of ECAC to Value Partners

Carnegie reported in its Form 10-SB that it sold its subsidiary, ECAC, to Value Partners, on January 30, 1998, for $100,000 cash. Carnegie issued a press release announcing the sale on February 9, 1998. The press release stated that "the sale is estimated at $2.1 million, which consists of debt assumption and cash." The basis for the gain was the assertion that ECAC owed Carnegie approximately $1.6 million and that the debt was collectible. In fact, Carnegie represented that the debt was paid in full in April 1999.

However, most of the representations made by Carnegie and its management to the SEC and to Grant Thornton about the collectibility of the amount stated to be due from ECAC, and about the appropriateness of gain recognition, were false. Carnegie's officers, representatives or agents fabricated a series of events, and created supporting documentation, to make it appear that ECAC's indebtedness was legitimate; that the indebtedness was fully collectible; and that the indebtedness had been paid in full as a result of the sale of collateral pledged by Nufield Investments.

In actuality, the purchaser of ECAC, Value Partners, never agreed that ECAC owed Carnegie any money. The $1,419,584 promissory note, which is dated January 21, 1998, was not signed until at least October 1998. The note was backdated to January 21, 1998 making it appear that ECAC had signed it before the business was sold for $100,000 cash to Value Partners. No stock was ever pledged as collateral for ECAC's indebtedness to Carnegie and the collateral was never sold.

Carnegie had no legitimate basis to claim that the amount Carnegie reported due from ECAC was collectible. Carnegie should not have reported any gain on the sale of the stock of ECAC to Value Partners.

At the time Carnegie filed its Form 10-SB, Grant Thornton was not aware that the reported gain on the sale of the stock of ECAC to Value Partners was misrepresented.

4. Carnegie Misrepresented the Sale of Talidan Assets to Westshire

Carnegie reported in its Form 10-SB that its Talidan subsidiary sold certain assets (known as the "print media business") to Westshire, on June 22, 1998, for a $2,340,000 promissory note. Carnegie recognized a gain of approximately $1.6 million on this transaction.

This transaction was not a legitimate, revenue-producing transaction because Westshire did not have sufficient independent means to pay the note. Payments on the note (which were directed by Gershberg and Pearl) originated from other sources and, in part, were orchestrated by selling Carnegie shares. This sale, too, was backdated to June 22, 1998 to falsify the fact that it was not completed in 1998.

Westshire was not the intended purchaser of the assets. Instead, Carnegie sold the assets to the former owners of Talidan, and Westshire was interposed as a middleman to make it appear that Carnegie had engaged in a revenue-producing activity. Carnegie's management fraudulently failed to disclose the actual nature of the transaction, including the plan that Westshire receive shares from the former owners of Talidan to pay the note. Carnegie's management reported this "sale" of the Talidan print media assets to Westshire as a legitimate, revenue-producing transaction. Carnegie s hould not have reported any gain on this transaction.

At the time of the filing of Carnegie's Form 10-SB, Grant Thornton was not aware that the recognition of gain was inappropriate.

5. Carnegie Misrepresented the Sale of Rights to Distribute MAVIS

On December 9, 1998, Carnegie issued a press release in which it "announced that it has entered into a definitive agreement with Tiller International . . . to license, market and distribute its proprietary MAVIS voice-activated platform in Russia . . . ." The press release continued with a statement by Farkas: "the license agreement is for $3.7 million (U.S.), and included 1,000 copies of MAVIS software in English and Russian."

In order for Carnegie to report the recognition of income on this transaction, the transaction had to have been completed, and Carnegie had to have complied with all of the terms of the distribution agreement by December 31, 1998. However, the sale of the rights to distribute MAVIS in Russia was not completed in 1998, and Carnegie had not complied with all of its obligations in 1998. Carnegie backdated the Distributor Agreement, and the representations Carnegie made concerning the completion of its obligations under the Distributor Agreement were false.

Because the sale of the rights to distribute MAVIS in Russia was not completed in 1998, and Carnegie had not complied with all of its obligations in 1998, it was not appropriate under applicable accounting principles for Carnegie to have reported income on the transaction in its December 31, 1998 financial statements. The misstatements or omissions of amounts or disclosures in Carnegie's December 31, 1998 financial statements resulted in an overstatement of Carnegie's income for that year (and periods within that year). Instead of reporting net income for the year ended December 31, 1998, Carnegie should have reported a $3,931,724 loss.

Carnegie's management had a significant personal financial stake in making it appear that Carnegie was a profitable company. In each of these transactions discussed above, Carnegie's management, representatives and agents attempted to make it appear that Carnegie was such a company.

At the time of the completion of Carnegie's December 31, 1998 financial statements, Grant Thornton was not aware that the sale of the rights to distribute MAVIS in Russia was not complete in 1998.

6. Carnegie Deceived Grant Thornton

The actions of Carnegie's management, representatives and agents deceived the preparers of its financial statements -- Grant Thornton. Grant Thornton advised Carnegie's management that it needed their cooperation to complete the audits of Carnegie's financial statements. The January 10, 1999 engagement letter for the audit of Carnegie's December 31, 1998 financial statements informed Carnegie that: "[O]ur completion of the audits will require management's cooperation. In addition, as required by generally accepted auditing standards, our procedures will include obtaining written representation from management concerning such matters which we will rely upon . . . ."

During the course of the audit of Carnegie's December 31, 1998 financial statements, Grant Thornton's auditors requested that Carnegie provide them with all relevant contracts and other supporting documents. The auditors also directed inquiries to Carnegie's management about the accounting for transactions and asked Carnegie's management to explain the basis for that accounting. In turn, Carnegie provided the auditors with certain documentation and with letters and memoranda justifying Carnegie's accounting for the transactions.

Grant Thornton's auditors evaluated this documentation and other information and relied upon Carnegie's management's statements in reaching a conclusion that Carnegie's December 31, 1998 financial statements were presented in conformity with GAAP in all material respects. In addition, as provided for in the January 10, 1999 engagement letter, and as required by GAAS, Carnegie's management supplied Grant Thornton with a letter containing management's written representations. This letter, signed by Gable, Farkas, Goldstein and Greene in their capacities as officers and directors of Carnegie, represented that Carnegie's management had provided all financial records and data, had disclosed all related party transactions, had disclosed all significant agreements, was unaware of any irregularities involving its management, and that there were no other material liabilities or gain or loss contingencies that were required to be disclosed.

As set forth previously, these representations were inaccurate. Carnegie's management failed to disclose important documents and information to the auditors, and it also made numerous misstatements about the transactions reported in Carnegie's December 31, 1998 financial statements and in Carnegie's Forms 10-SB, 10-SB/A and 10-KSB. Carnegie also misstated or omitted such information in letters written to the SEC. By engaging in such conduct, Carnegie's management misled the auditors and deceived them into concluding that Carnegie's December 31, 1998 financial statements were presented in conformity with GAAP in all material respects.

The Court does not find that expert testimony is necessary to reach the conclusion that the misstatements and omissions of Carnegie's management deceived and misled Grant Thornton thereby thwarting Grant Thornton's efforts to audit Carnegie's 1998 financial statements in conformity with GAAP. However, if the Court required such opinion it was supplied through the testimony of Grant Thornton's expert Ten Eyck. The Court credits, accepts, and relies upon Ten Eyck's opinion to the extent that any such reliance is necessary.

B. Carnegie Was Contributorily Negligent

Contributory negligence is a complete bar to recovery in Maryland. Harrison v. Montgomery County Bd. of Educ., 295 Md. 442 (1983); Prudential Sec., Inc. v. E-Net, Inc., 140 Md. App. 194, 226 (2001) (citing Kassama v. Magat, 136 Md. App. 637 (2001)). The burden of proving contributory negligence rests on the defendant. Faith v. Keefer, 127 Md. App. 706, 746 (1999). A corporation can be contributorily negligent if the corporation's officers, directors or agents failed to exercise the degree of reasonable and ordinary care that a prudent person would use under similar circumstances. See, e.g., Prudential Sec., Inc., 140 Md. App. at 229 (affirming finding that plaintiff corporation was contributorily negligent based on actions of its employees); Wegad v. Howard Street Jewelers, Inc., 326 Md. 409, 420-22 (contributory negligence of corporation based on the negligent acts of its principals).

Contributory negligence is applicable in accounting malpractice cases, and it is an absolute defense if the client's negligence contributed to the client's alleged injuries. See Wegad, 326 Md. at 418 (client should not be insulated from its own shortcomings); E. F. Hutton Mortgage Corp., 690 F. Supp. 1465 (D.Md. 1988) (plaintiff's contributory negligence barred recovery against accountant). In Wegad, the Court of Appeals denied recovery to the client of an accountant on the ground that the client's proper supervision of the accountant may have independently disclosed the source of the client's alleged injuries. Wegad, 326 Md. 409. The Court noted that "[w]e do not believe that a client can discharge its duty to protect itself by closing its eyes and refraining from taking any action other than employing an accountant when prudence requires that it should also take independent measures to shield itself from harm." Id. at 420.

The Court does not recite here the factual findings on which it has concluded that Carnegie's officers, representatives and agents were negligent. Those facts are set forth above at "XIA", in some detail. Here it is sufficient to point out that the intentional nature of a client's acts does not preclude a finding of contributory negligence. See Stratton v. Sacks, 99 B.R. 686 (1989) (Harvey, J).[12] Carnegie's failure to disclose its affiliation and inaccurate reporting of the four transactions in 1998, as set forth above, was, at a minimum, negligent. That negligence caused Carnegie's financial statements to be materially inaccurate and the SEC to scrutinize its representations. Accordingly, the plaintiffs are barred from recovering from Grant Thornton for any alleged negligence by it.

To the extent that the plaintiffs attempt to place the blame on Grant Thornton for failing to uncover Carnegie's management's conduct, the attempt fails for several reasons. First, Grant Thornton was not required to comb Carnegie's files to search for documents is an effort to police Carnegie's management, representatives and agents to provide material information. "Auditors are not detectives hired to ferret out fraud . . . ." Cenco Inc., 686 F.2d at 454. It was Carnegie's duty to provide accurate and complete information regarding its operations and transactions that were material to the financial statements. Second, GAAS specifically recognizes that intentional conduct by a company's management may prevent an auditor from detecting material misstatements in financial statements. AICPA Professional Standards, Section 316.10.

XII. CONCLUSION

In summary, the plaintiffs have failed to prove the elements of any of their claims against Grant Thornton or their negligence claim against Flach. The plaintiffs have also failed to prove any quantifiable damages as a result of the trading halt or that any action or omission of Grant

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[12] The Court also held that any negligent conduct by the accountants could not be the proximate cause of any damage to the company in light of the fraudulent and negligent acts of its officers.

Thornton's caused them damage. Grant Thornton, on the other hand, has convincingly proven that Carnegie, by the misstatements and omissions of its management, representatives and agents, thwarted Grant Thornton's efforts to audit Carnegie's financial statements according to GAAP.

Grant Thornton fulfilled its responsibility to provide independent accounting; the SEC fulfilled its responsibility to provide conscientious government oversight, and the AMEX fulfilled its responsibility to protect potential investors – all before the manipulations of Carnegie's management resulted in the widespread public trading in Carnegie's stock. Even if Carnegie had proven a claim resulting in damage against Grant Thornton, equity would prevent this Court from rewarding a wrongdoer.

Judgment will be entered for defendants and against plaintiffs with costs to be paid by plaintiffs.

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Date	Kaye A. Allison Judge