No. 5PA15 TWENTY-FIFTH JUDICIAL DISTRICT

SUPREME COURT OF NORTH CAROLINA

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COMMSCOPE CREDIT UNION,	)	
Plaintiff-Appellee	)	
v.	)	From Catawba County 12 CVS 3021 COA 14-273
BUTLER & BURKE, LLP, a North Carolina Limited Liability Partnership,	)	
Defendant-Appellant	)	
v.	)	
BARRY D. GRAHAM et al.,	)	
Third-Party Defendants	)	

****

MOTION OF THE NORTH CAROLINA ASSOCIATION OF CERTIFIED PUBLIC ACCOUNTANTS, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, AND CENTER FOR AUDIT QUALITY FOR LEAVE TO FILE BRIEF OF *AMICI CURIAE*

****

TO THE HONORABLE SUPREME COURT OF NORTH CAROLINA:

NOW COME the North Carolina Association of Certified Public Accountants, American Institute of Certified Public Accountants and Center for Audit Quality, and hereby move the Court, pursuant to Rule 28(i) of the North

Carolina Rules of Appellate Procedure, for leave to file a brief of *amici curiae* in support of Defendant-Appellant Butler & Burke, LLP.

Proposed amici conditionally submit the attached brief of *Amici Curiae* with this Motion. In support of this motion, proposed amici show to the Court the following:

Nature of Applicants' Interest

The North Carolina Association of Certified Public Accountants (NCACPA) is dedicated to promoting the competence, integrity, civic responsibility, and success of CPAs in North Carolina. Since its founding in 1919, it has grown to more than 14,000 members, serving all aspects of the accounting profession. NCACPA offers a comprehensive curriculum of professional education and is committed to maintaining the highest standards of professional excellence in accounting practice in North Carolina. NCACPA's committees, chapters, task forces, and advisory groups regularly interact with the North Carolina State Board of CPA Examiners, the Internal Revenue Service, and other regulators who shape state and national accounting standards. Based on its role, history, and experience as a member service organization for North Carolina CPAs, NCACPA has a strong interest in issues affecting the independence of auditors.

The American Institute of Certified Public Accountants (AICPA) is the world's largest member association representing the accounting profession, with approximately 400,000 members in 128 countries and a 126-year history of serving the public interest. AICPA's diverse membership represents many areas of practice, including public accounting, auditing, business and industry, government, education, and consulting. AICPA has been an authoritative source in the development of auditing and accounting standards and in issuing publications to improve the quality of services provided by CPAs. AICPA maintains a strong interest in auditor independence and the scope and bases of civil liability sought to be imposed on auditors.

The Center for Audit Quality (CAQ) is a public policy organization formed in 2007 to increase investor confidence and public trust in the global capital markets by improving the reliability of public company audits and enhancing their relevance for investors. CAQ's members include approximately 550 audit firms, most of which are public company audit firms registered with the Public Company Accounting Oversight Board. Because CAQ's mission is to foster high quality performance by public company auditors and to advocate for standards that promote auditors' objectivity, effectiveness, and responsiveness to dynamic market conditions, CAQ also has a strong interest in public company auditors' independence.

Why an Amicus Curiae Brief is Desirable

Amici do not have a direct stake in this particular dispute. They are, however, deeply concerned on behalf of their members and the public about the decision of the Court of Appeals, which threatens the principle of auditor independence. Although it is unclear whether the court believed a standard audit engagement creates a fiduciary relationship in every case, the court concluded—without mentioning auditor independence or professional auditing standards—that an auditor-client relationship "appears much more like that between attorney and client" or "broker and principal . . . than that between mutually interdependent businesses." Slip op. 8-9 (citation and internal quotation marks omitted). The court did not hold that accountants and their audit clients have a fiduciary relationship "as a matter of law." Slip op. 9. Instead, the Court of Appeals concluded that an auditor's statements in its engagement letter, including that "it had special expertise in providing auditing services to credit unions," were sufficient to state a claim against the auditor for breach of fiduciary duty. Slip op. 2, 9-10. By leaving open the possibility that a standard audit engagement could create a fiduciary relationship, the Court of Appeals erred.

The Court of Appeals' decision demonstrates a significant misunderstanding of auditor independence—an essential component of an auditor's responsibilities. Holding that an auditor may owe a fiduciary duty to an audit client conflicts with North Carolina and federal law, as well as professional auditing standards: Auditors must be *independent* of their audit clients, and independence is inconsistent with the nature of a fiduciary relationship, as courts throughout the country have recognized. If allowed to stand, the Court of Appeals' holding could hinder North Carolina CPAs from conducting independent audits, which are essential to North Carolina businesses, their investors, and the State's economy as a whole.

Issue of Law to be Addressed

The brief of proposed *amici curiae* addresses the question whether an auditor engaged to conduct an audit is or may be a fiduciary of the subject of the audit under North Carolina law, notwithstanding state and federal law requiring an auditor to be independent.

Identity of the Party Supported

The brief submitted by proposed *amici curiae* supports Defendant-Appellant and requests reversal of the decision of the Court of Appeals.

This the 6th day of April, 2015.

SMITH, ANDERSON, BLOUNT, DORSETT, MITCHELL & JERNIGAN, L.L.P.

By: /s/ J. Mitchell Armbruster

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Rule 33(b) statement: I certify that all of the attorneys listed below have authorized me to list their names on this document as if they had personally signed it:

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CERTIFICATE OF SERVICE

I hereby certify that the foregoing motion was served upon the parties to this action by mailing a copy thereof by first class mail to the following counsel:

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This the 6th day of April, 2015.

_/s/ J. Mitchell Armbruster__________
J. Mitchell Armbruster

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No. 5PA15 TWENTY-FIFTH JUDICIAL DISTRICT

SUPREME COURT OF NORTH CAROLINA

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COMMSCOPE CREDIT UNION, Plaintiff-Appellee, v. BUTLER & BURKE, LLP, a North Carolina Limited Liability Partnership, Defendant-Appellant, v. BARRY D. GRAHAM et al., Third-Party Defendants.	)	<u>From Catawba County</u> 12 CVS 3021 COA 14-273

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BRIEF OF *AMICI CURIAE*
NORTH CAROLINA ASSOCIATION OF
CERTIFIED PUBLIC ACCOUNTANTS,
AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS,
AND CENTER FOR AUDIT QUALITY
IN SUPPORT OF APPELLANT

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No. 5PA15 TWENTY-FIFTH JUDICIAL DISTRICT

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BRIEF OF *AMICI CURIAE*
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IN SUPPORT OF APPELLANT

* * * * * * * * * * * * * * * * * *

INTEREST AND IDENTITY OF *AMICI CURIAE*

The North Carolina Association of Certified Public Accountants (NCACPA) is dedicated to promoting the competence, integrity, civic responsibility, and success of CPAs in North Carolina. Since its founding in 1919, it has grown to more than 14,000 members, serving all aspects of the accounting profession. NCACPA offers a comprehensive curriculum of professional education and is committed to maintaining the highest standards of professional excellence in accounting practice in North Carolina. NCACPA's committees, chapters, task forces, and advisory groups regularly interact with the North Carolina State Board of CPA Examiners, the Internal Revenue Service, and other regulators who shape state and national accounting standards. Based on its role, history, and experience as a member service organization for North Carolina CPAs, NCACPA has a strong interest in issues affecting the independence of auditors.

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Amici do not have a direct stake in this particular dispute. They are, however, deeply concerned on behalf of their members and the public about the decision of the Court of Appeals, which threatens the principle of auditor independence. Although it is unclear whether the court believed a standard audit engagement creates a fiduciary relationship in every case, the court concluded—without mentioning auditor independence or professional auditing standards—that an auditor-client relationship "appears much more like that between attorney and client" or "broker and principal . . . than that between mutually interdependent businesses." Slip op. 8-9 (citation and internal quotation marks omitted). The court did not hold that accountants and their audit clients have a fiduciary relationship "as a matter of law." Slip op. 9. Instead, the Court of Appeals concluded that an auditor's statements in its engagement letter, including that "it had special expertise in providing auditing services to credit unions," were sufficient to state a claim against the auditor for breach of fiduciary duty. Slip op. 2, 9-10. By leaving open the possibility that a standard audit engagement could create a fiduciary relationship, the Court of Appeals erred.

The Court of Appeals' decision demonstrates a significant misunderstanding of auditor independence—an essential component of an auditor's responsibilities. Holding that an auditor may owe a fiduciary duty to an audit client conflicts with North Carolina and federal law, as well as professional auditing standards: Auditors must be *independent* of their audit clients, and independence is inconsistent with the nature of a fiduciary relationship, as courts throughout the country have recognized. If allowed to stand, the Court of Appeals' holding could hinder North Carolina CPAs from conducting independent audits, which are essential to North Carolina businesses, their investors, and the State's economy as a whole. *Amici* respectfully urge this Court to reverse the Court of Appeals' decision.[1]

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[1] In this brief, *Amici* address only the first question this Court will review.

ARGUMENT

I. Independence Is a Bedrock Principle of Auditing Practice.

An audit is a specific type of service performed by an accountant. An auditor tests "the financial statements of an entity" by examining the entity's books—"the underlying accounting records and supporting evidence"—and "issues an opinion stating whether such statements fairly represent the financial status of the audited entity." *Bily v. Arthur Young & Co.*, 834 P.2d 745, 749 (Cal. 1992) (citation omitted). Accountants can provide other services. A company, for example, may engage an accountant to prepare financial statements and provide bookkeeping services on its behalf; the accountant who had responsibility for preparing the financial statements, however, *cannot* also audit the financial statements. That is because, when performing an audit, the accountant must act with objectivity and skepticism to meet "the public['s] demand[for] a sober and impartial evaluation of fiscal performance." *Id.* at 399-400, 834 P.2d at 762 (citation omitted). "This 'public watchdog' function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust." *United States v. Arthur Young & Co.*, 465 U.S. 805, 818 (1984).

For decades, AICPA has described independence as "both historically and philosophically . . . the foundation of the public accounting profession." AICPA, *Audits by Certified Public Accountants: Their Nature and Significance* 25 (1950). "Independence implies an impartiality that recognizes an obligation to be fair not only to management and those charged with governance of an entity but also users of the financial statements who may rely upon the independent auditor's report." AICPA Auditing Standard AU-C § 200.A17 (App. 7).

A. North Carolina Law and AICPA Standards Demand that an Auditor Be Independent.

In North Carolina, an accountant who is engaged to audit financial statements for a client "must be independent with respect to the client in fact and appearance." 21 N.C. Admin Code 08N.0402(a) (App. 1).[2] "Independence is impaired if," for example, an auditor is "simultaneously associated with the audit client as a [d]irector, officer, employee, or in any capacity equivalent to that of a member of management." *Id.* 08N.0402(d)(1) (punctuation omitted). A CPA may "not render auditing services unless the CPA has complied with the applicable generally accepted auditing standards"—that is, the "Statements on Auditing Standards issued by the AICPA." *Id.* 08N.0403 (App. 2). North Carolina law thus incorporates AICPA standards.

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[2] The North Carolina Board of Certified Public Accountant Examiners has authority to adopt and enforce ethics and conduct rules for CPAs. N.C. Gen. Stat. § 93-12(9). Chapter 8 of Title 21 of the North Carolina Administrative Code contains the rules promulgated by the Board.

AICPA standards emphasize the fundamental purpose of an independent audit. An opinion from an independent outside auditor is designed to "enhanc[e] the degree of confidence that intended users can place in the financial statements." AU-C § 200.04 (App. 4). An auditor therefore "must be without bias with respect to the client," and strive for "a judicial impartiality." AU § 220.02 (App. 8). It is not enough that an auditor *be* independent: an auditor must also "be *recognized* as independent." *Id.* § 220.03 (emphasis in original) (App. 8); *see also* AU-C § 200.A17 ("The concept of independence refers to both independence in fact and independence in appearance.") (App. 7). To appear independent, an auditor "must be free from any obligation to . . . the client, its management, or its owners." AU § 220.03 (App. 8).[3]

Auditors are also ethically obligated to be independent. The AICPA Code of Professional Conduct underscores that any relationship where an auditor would be "reviewing . . . evidence that results from their own" work, such as "preparing source documents used to generate the client's financial statements," or

[3] Over time, AICPA standards have been subject to recodification. The standards cited in this brief as "AU" sections are those applicable during the time period at issue in this case, 2001–2009. The current standards, which became effective in December 2012, are cited as "AU-C" sections. AICPA standards continue to emphasize the fundamental requirement of auditor independence. *See, e.g.*, AICPA Auditing Standard AU-C § 200.15 ("When the auditor is not independent . . . the auditor is precluded from issuing a report under [generally accepted auditing standards].").

"promoting an attest client's interests or position" is a threat independence. AICPA Code ET §§ 100-1.13, 100-1.14.[4] (App. 12). Thus, for example, an accountant who "prepare[s] source documents" or "serve[s] as a fiduciary as defined by ERISA" *cannot* maintain the independence required to perform an audit. *Id*. § 101.05 (App. 20); *accord* AICPA Code § 1.295.115, § 1.295.120.

B. Federal Law Also Requires an Auditor To Be Independent.

Recognizing the public interest in independent audits, Congress in 2002 amended the Securities Exchange Act of 1934 to tighten pre-existing independence requirements and preclude independent auditors from offering certain additional services to their clients. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 201, 116 Stat. 745, 771-72 (amending 15 U.S.C. § 78j-1). Auditors may not provide, for example, "bookkeeping," "actuarial services," "management functions," "broker or dealer" services, or "legal services." 15 U.S.C. § 78j-l (g)(1), (4), (6)-(8). Congress thus prevented auditors from acting on behalf of their clients in settings that might impair their independence.

The U.S. Securities and Exchange Commission also has long demanded that auditors be "independent of their audit clients both in fact and in appearance." 17 C.F.R. § 210.2-01, Prelim. Note 1 (App. 26). It is "unlawful for an auditor not to

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4 AICPA Code ET Section 100 ("Independence") applied during the time period at issue in this case. Similar ethical rules on independence are currently codified at AICPA Code § 1.200.

be independent," 17 C.F.R. § 240.10A-2 (App. 39), and the SEC "will not recognize an accountant as independent" unless the accountant is "capable of exercising objective and impartial judgment on all issues encompassed within the accountant's engagement," 17 C.F.R. § 210.2-01, Prelim. Note 3(a) (App. 27). The SEC, for example, restricts an auditor from creating "a mutual . . . interest between the accountant and the audit client" or "acting as management" for a client. *Id.* § 210-2.01, Prelim. Note 2 (App. 26).

Congress also established the Public Company Accounting Oversight Board (PCAOB or Board) "to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports." Sarbanes-Oxley Act § 101, 15 U.S.C. § 7211(a). Congress tasked the Board to adopt rules "in the public interest" to help ensure auditor independence. *Id.* § 103, 15 U.S.C. § 7213(a)(1). The Board requires, for example, that firms registered with the Board "must be independent of the firm's audit client throughout the audit and professional engagement period." PCAOB Rule 3520 (App. 23). If not, the Board, among other things, "may impose such disciplinary or remedial sanctions as it determines appropriate." PCAOB Rule 5300(a) (App. 24).

C. The Court of Appeals Erred by Equating an Audit Relationship with a Fiduciary Relationship.

North Carolina law, AICPA professional standards and ethics rules, and federal law all require that auditors be independent of their audit clients. North

Carolina's CPAs cannot fulfill that demand if they must also be fiduciaries of their audit clients. The two obligations are fundamentally inconsistent.

A "fiduciary relationship" exists when one party has a legal duty to act "for the benefit of another upon matters within the scope of the relation." Restatement (Second) of Torts § 874 cmt. a (1979). It arises "where there has been a special confidence reposed in one who in equity and good conscience is bound to act in good faith and with due regard to the interests of the one reposing confidence." *Abbitt v. Gregory*, 201 N.C. 577, 598, 160 S.E. 896, 906 (1931). Fiduciary relationships, such as between spouses, attorney and client, trustee and beneficiary, and partners to a partnership involve "confidence reposed on one side, and resulting domination and influence on the other." *Dallaire v. Bank of Am., N.A.*, 367 N.C. 363, 367, 760 S.E.2d 263, 266 (2014) (citations and internal quotation marks omitted). Because a fiduciary's duty is "to act in the best interests of the other party," *id.*, a fiduciary relationship cannot be reconciled with an objective and impartial independent relationship.

The Court of Appeals therefore erred in analogizing the auditor-client relationship to "that between attorney and client" or between "broker and principal." Slip op. 8-9. An attorney must be "a loyal representative whose duty it is to present the client's case in the most favorable possible light." *Arthur Young*, 465 U.S. at 817. But an auditor must be a "disinterested analyst" with "a *public* responsibility transcending any employment relationship with the client." *Id.* at 817-18. Moreover, federal law *forbids* independent auditors from offering brokerage or legal services to their audit clients, 15 U.S.C. § 78j-1(g)(7)-(8), further undermining the court's analogy.

The court noted that auditors are "specially trained … to perform comprehensive audits," slip op. 8, but this does not make an auditor a fiduciary any more than it makes any competent professional in a given field a fiduciary. *See Pommier v. Peoples Bank Marycrest*, 967 F.2d 1115, 1119 (7th Cir. 1992) ("We trust most people with whom we choose to do business."). A fiduciary relationship arises where one party exercises "domination," *Dallaire*, 367 N.C. at 367, 760 S.E.2d at 266, but this Court has explained that "auditors do not control their client's accounting records and processes," *Raritan River Steel Co. v. Cherry, Bekaert & Holland*, 322 N.C. 200, 212, 367 S.E.2d 609, 616 (1988).

The Court of Appeals relied on *Smith v. Underwood*, 127 N.C. App. 1, 487 S.E.2d 807 (1997), "where the accountants were providing accounting and tax-related services." Slip op. 8. But auditing services should not be confused with other services accountants provide. Even if the court were correct that accountants performing certain non-audit services for their clients may incur a fiduciary responsibility,[5] it would not follow that *independent auditors* are fiduciaries. An audit "client, of course, has interests in the audit that may not be consonant with those of the public. Management seeks to maximize the stockholders' and creditors' confidence in the company, within the bounds of [GAAP and GAAS]; whereas, the public demands a sober and impartial evaluation of fiscal performance." *Bily*, 3 Cal. 4th at 399-400, 834 P.2d at 762 (citation and internal quotation marks omitted; brackets in original). A fiduciary would have to seek the best interest of the client, *Dallaire*, 367 N.C. at 367, 760 S.E.2d at 266, but an independent auditor "owes ultimate allegiance" to the public, *Arthur Young*, 465 U.S. at 818.

* * *

The Court of Appeals recognized a common law fiduciary duty arising out of independent audits. That duty is inconsistent with the nature of the audit, as set forth in state and federal law as well as professional standards for auditors. Accordingly, this Court should reverse.

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[5] *But see, e.g.*, *Iacurci v. Sax*, 99 A.3d 1145, 1155 (Conn. 2014) ("[C]ourts in other jurisdictions . . . have concluded that a fiduciary relationship does not exist when a client relationship is limited to the preparation of tax returns." (collecting cases)).

II. Other Courts Have Held That the Auditor-Client Relationship Is Not a Fiduciary Relationship.

No prior North Carolina appellate decision squarely addressed the issue of whether an independent auditor has a fiduciary relationship with the audit client.[6] Nearly every court to consider the issue has rejected the notion that an audit engagement creates a fiduciary relationship: "An *independent* auditor's primary duty is to the public and this is inconsistent with a fiduciary status." *Micro Enhancement Int'l, Inc. v. Coopers & Lybrand, LLP*, 110 Wash. App. 412, 434, 40 P.3d 1206, 1218 (2002) (collecting cases).

"The duty of a traditional fiduciary is to act 'in a representative capacity for another in dealing with the property of the other,' whereas an auditor acts 'independently, objectively and impartially, and with the skills which it represented to its clients that it possessed.' " *Resolution Trust Corp. v. KPMG Peat Marwick*, 844 F. Supp. 431, 436 (N.D. Ill. 1994) (quoting *Franklin Supply Co. v. Tolman*, 454 F.2d 1059, 1065 (9th Cir. 1971)); *see also Stewart v. Wilmington Trust SP Servs., Inc.*, C.A. No. 9306-VCP, 2015 WL 1396382, at *15-16 (Del. Ch. Mar. 26, 2015) (App. 58) (dismissing fiduciary duty claims against

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[6] The North Carolina accounting cases cited by the Court of Appeals did not address audit engagements and therefore do not resolve the question. In *Harrold v. Dowd*, 149 N.C. App. 777, 561 S.E.2d 914 (2002), a non-audit relationship with an accountant was held not to create a fiduciary duty. And in *Smith v. Underwood*, 127 N.C. App. 1, 487 S.E.2d 807 (1997), the accountant did not perform an audit.

auditors because auditors did not control client's property or client's affairs and have a duty to be independent from client). "Although an auditor may be charged with duties," therefore, "they are *not duties as a fiduciary*." *FDIC v. Schoenberger*, 781 F. Supp. 1155, 1158 (E.D. La. 1992) (emphasis added).

Courts have generally held that "[t]he mere fact that an accountant has been hired to audit a company, " is "insufficient to establish a relationship of special trust and confidence giving rise to fiduciary obligations." *Golden W. Ref. v. Pricewaterhouse*, 392 F. Supp. 2d 407, 414 (D. Conn. 2005) (citation and internal quotation marks omitted); *Stewart*, 2015 WL 1396382, at *16 (App. 58) ("The mere provision of audit services does not of itself convert an auditor into a fiduciary of the corporation."); *see also, e.g., Strategic Capital Res., Inc. v. Citrin Cooperman & Co., LLP*, 213 Fed. App'x 842, 843 (11th Cir. 2007); *Wright v. Sutton*, No. 1:08-1431, 2011 WL 1232607, at * 5 (S.D. W. Va. Mar. 29, 2011); *Standard Chartered PLC v. Price Waterhouse*, 190 Ariz. 6, 23, 945 P.2d 317, 334 (Ariz. Ct. App. 1996); *cf. Painters of Phila.. Dist. Council No. 21 Welfare Fund v. Price Waterhouse*, 879 F.2d 1146, 1150 (3d Cir. 1989) ("Congress chose to describe an accountant qualified to perform an audit as 'independent.' We find this fundamentally at odds with any notion that such an accountant would be [an ERISA] plan fiduciary.").

Some courts have suggested that a fiduciary relationship "may exist" between a company and its auditor in the extraordinary case where the auditor goes *beyond* performing an audit—by "manag[ing] the assets or business of a client," for example. *In re Cendant Corp. Sec. Litig.*, 139 F. Supp. 2d 585, 609 (D.N.J. 2001). But an accountant's role would have to go "outside the normal role of independent auditor" in order "to give rise to a fiduciary relationship." *In re SmarTalk Teleservices, Inc. Sec. Litig.*, 487 F. Supp. 2d 928, 932 (S.D. Ohio 2007). The Court of Appeals cited no facts that would remove this case from the general rule that "an accountant does not owe a fiduciary duty to its client when performing the services of an auditor." *Id.*

Besides the Court of Appeals decision under review, *Amici* are aware of only two cases suggesting that an independent auditor has a fiduciary relationship with the audit client. Neither is persuasive. The first merely asserts, without citation, that: "Plainly an independent auditor's obligation to investigate and disclose brings the accountant-client relationship within the ambit of fiduciary relationships." *In re Investors Funding Corp. of New York Sec. Litig.*, 523 F. Supp. 533, 543 (S.D.N.Y. 1980). *But see, e.g.*, *Rothman v. Gregor*, 220 F.3d 81, 98 (2d Cir. 2000) (describing auditor as "a non-fiduciary accountant"). The second proclaims that accountants "[w]hen performing audits" are fiduciaries of their clients under Michigan law, but it relied exclusively on a case that did not actually involve auditing. *In re DeLorean Motor Co.*, 56 B.R. 936, 945 (Bankr. E.D. Mich. 1986) (citing *Shwayder Chem. Metallurgy Corp. v. Baum*, 225, 206 N.W.2d 484 (Mich. App. 1973)); *see also Banker & Brisebois Co. v. Maddox*, 2014 WL 1720285, at *6 (Mich. Ct. App. Apr. 29, 2014) (App. 49) ("There is no Michigan caselaw holding that an accountant generally owes a fiduciary duty to his or her clients. Rather, Michigan . . . only finds a fiduciary relationship when special facts support such a heightened duty."). As neither *Investors Funding Corp.* nor *DeLorean Motor Co.* discussed auditor independence, it is not surprising that each has been squarely rejected by other courts. *See Resolution Trust Corp.*, 844 F. Supp. at 436 (rejecting *Investors Funding Corp.*); *Micro Enhancement Int'l*, 40 P.3d at 1218 n.4 (rejecting both).

Where an audit client has alleged a fiduciary duty simply by virtue of the audit engagement, as here, fiduciary duty claims have been rejected. *See*, *e.g.*, *Micro Enhancement Int'l*, 40 P.3d at 1218 ("placing trust and confidence in firm as independent advisor [is] insufficient to create [a] fiduciary duty" (citation and internal quotation marks omitted)). This Court should recognize the overwhelming weight of well-reasoned authority and reverse the Court of Appeals.

III. Imposing a Fiduciary Duty Would Harm North Carolina's Accountants, Businesses, Investors, and Economy.

Independence and fiduciary duty impose conflicting demands on auditors: One requires them to be impartial and objective, serving the public interest and maintaining total independence from their clients in fact and appearance; the other insists that they serve their clients with undivided loyalty, acting always in their client's best interests.

If the decision of the Court of Appeals is not overturned it will produce uncertainty in the market and cause CPAs to question whether and how they can continue to offer audit services in North Carolina with the independence required by law and professional standards. Even if the auditor-client relationship is not deemed a fiduciary relationship in every case, CPAs will hesitate to take the risk that their standard engagement letters will later be viewed as having created fiduciary relationships. And if CPAs were to continue performing audits in North Carolina, they would risk being sued for breach of fiduciary duty whenever a "bad result" occurs. Avoiding those risks will almost certainly lead to fewer CPAs willing to perform independent audits in North Carolina, if they are able to offer independent audits at all. That would have a negative impact on North Carolina's businesses, investors, and economy. If fewer CPAs offer audits, companies would have to pay more to those who will. Investors and consumers will also be unsure, in every instance, whether the audit will be made subject to a fiduciary duty, retroactively threatening the lawfulness of the audit.

Under state and federal law, and the generally accepted auditing standards of the AICPA (which have the force of law), North Carolina CPAs cannot issue valid audit reports unless they are independent from their clients. But auditors are not independent if they owe a fiduciary duty to their audit clients. Moreover, state law requires many North Carolina entities—including credit unions—to obtain independent audits. *See, e.g.*, 04 NCAC 06C.0305 (requiring an annual audit of state-chartered credit unions "performed using generally accepted auditing procedures"); N.C. Gen. Stat. § 54-109.49 (credit unions must have annual audit according to "regulations promulgated by the Administrator of Credit Unions"). North Carolina CPAs have a duty to perform independent audits and North Carolina credit unions must ensure they are *obtaining* independent audits, but it is difficult to see how either can do so if a standard audit engagement establishes a fiduciary relationship.

Nearly every court to consider whether independent auditors are fiduciaries of their audit-clients has concluded that they are not. If this Court does not reverse the Court of Appeals, then North Carolina would be at odds with every other jurisdiction that has directly addressed this issue. Because that could prevent CPAs from offering and North Carolina businesses from obtaining independent audits, which are essential for public confidence in financial statements, *Amici* urge this Court to reverse the decision of the Court of Appeals.

CONCLUSION

This Court should reverse the Court of Appeals, uphold longstanding principles of auditor independence, and hold that an auditor-client relationship does not give rise to a fiduciary relationship.

This the 6th day of April, 2015.

SMITH, ANDERSON, BLOUNT, DORSETT,
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CONTENTS OF APPENDIX

21 NCAC 08N .0402 INDEPENDENCE

(a) A CPA, or the CPA's firm, who is performing an engagement in which the CPA, or the CPA's firm, will issue a report on financial statements of any client (other than a report in which lack of independence is disclosed) must be independent with respect to the client in fact and appearance.

(b) Independence is impaired if, during the period of the professional engagement, a covered person:

(1) Had or was committed to acquire any direct or material indirect financial interest in the client.

(2) Was a trustee of any trust or executor or administrator of any estate if such trust or estate had or was committed to acquire any direct or material indirect financial interest in the client; and

(A) The covered person (individually or with others) had the authority to make investment decisions for the trust or estate;

(B) The trust or estate owned or was committed to acquire more than 10 percent of the client's outstanding equity securities or other ownership interests; or

(C) The value of the trust's or estate's holdings in the client exceeded 10 percent of the total assets of the trust or estate.

(3) Had a joint closely held investment that was material to the covered person.

(4) Except as permitted in the AICPA Professional Standards Code of Professional Conduct and Bylaws, had any loan to or from the client or any officer or director of the client, or any individual owning 10 percent or more of the client's outstanding equity securities or other ownership interests.

(c) Independence is impaired if during the period of the professional engagement, a shareholder, a member, a partner or professional employee of the firm, his or her immediate family and close relatives, (as defined in the AICPA Code of Professional Conduct and Bylaws) or any group of such persons acting together owned more than five percent of a client's outstanding equity securities or other ownership interests.

(d) Independence is impaired if, during the period covered by the financial statements, or during the period of the professional engagement, a shareholder, a member, a partner or professional employee of the firm was simultaneously associated with the client as a:

(1) Director, officer, employee, or in any capacity equivalent to that of a member of management;

(2) Promoter, underwriter, or voting trustee; or

(3) Trustee for any pension or profit-sharing trust of the client.

(e) For the purposes of this Rule "Covered" person is

(1) An individual on the attest engagement team;

(2) An individual in a position to influence the attest engagement;

(3) A partner or manager who provides nonattest services to the attest client beginning once he or she provides 10 hours of nonattest services to the client within any fiscal year and ending on the later of the date:

(A) the firm signs the report on the financial statements for the fiscal year during which those services were provided; or

(B) he or she no longer expects to provide 10 or more hours of nonattest services to the attest client on a recurring basis;

(4) A partner in the office in which the lead attest engagement partner primarily practices in connection with the attest engagement;

(5) The firm, including the firm's employee benefit plans; or

(6) An entity whose operating, financial, or accounting policies can be controlled (as defined by generally accepted accounting principles (GAAP) for consolidation purposes) by any of the individuals or entities described in Subparagraphs (1) through (5) of this Paragraph or by two or more such individuals or entities if they act together;

(f) The impairments of independence listed in this Rule are not intended to be all-inclusive.

History Note: Authority G.S. 55B-12; 57C-2-01; 93-12(9);
Eff. April 1, 1994;
Amended Eff. February 1, 2011; April 1, 2003.

21 NCAC 08N .0403 AUDITING STANDARDS

(a) Standards for Auditing Services. A CPA shall not render auditing services unless the CPA has complied with the applicable generally accepted auditing standards.

(b) Statements on Auditing Standards. The Statements on Auditing Standards issued by the AICPA, including subsequent amendments and editions, are hereby adopted by reference, as provided by G.S. 150B-21.6, and shall be considered generally accepted auditing standards for the purposes of Paragraph (a) of this Rule.

(c) Departures. Departures from the statements listed in Paragraph (b) of this Rule must be justified by those who do not follow them as set out in the statements.

(d) Copies of Statements. Copies of the Statements on Auditing Standards may be inspected in the offices of the Board, as described in 21 NCAC 08A .0102. Copies may be obtained from the AICPA, 220 Leigh Farm Road, Durham, NC 27707 as part of the "AICPA Professional Standards." They are available at cost, which is one hundred sixty-nine dollars ($169.00) in paperback form or four hundred eighty-six dollars ($486.00) in looseleaf subscription form as of the effective date of the last amendment to this Rule.

History Note: *Authority G.S. 55B-12; 57C-2-01; 93-12(9);*
Eff. April 1, 1994;
Amended Eff. July 1, 2010; February 1, 2006.

AU-C Section 200

Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards

Source: SAS No. 122; SAS No. 123.

Effective for audits of financial statements for periods ending on or after December 15, 2012.

NOTE

In February 2014, the Auditing Standards Board issued SAS No. 128, *Using the Work of Internal Auditors* (sec. 610), which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2014, and can be viewed in appendix B of section 610 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the independent auditor's overall responsibilities when conducting an audit of financial statements in accordance with generally accepted auditing standards (GAAS). Specifically, it sets out the overall objectives of the independent auditor (the auditor) and explains the nature and scope of an audit designed to enable the auditor to meet those objectives. It also explains the scope, authority, and structure of GAAS and includes requirements establishing the general responsibilities of the auditor applicable in all audits, including the obligation to comply with GAAS.

.02 GAAS are developed and issued in the form of Statements on Auditing Standards (SASs) and are codified into AU-C sections. GAAS are written in the context of an audit of financial statements by an auditor. They are to be adapted as necessary in the circumstances when applied to audits of other historical financial information. GAAS do not address the responsibilities of the auditor that may exist in legislation, regulation, or otherwise, in connection with, for example, the offering of securities to the public. Such responsibilities may differ from those established in GAAS. Accordingly, although the auditor may find aspects of GAAS helpful in such circumstances, it is the responsibility of the auditor to ensure compliance with all relevant legal, regulatory, or professional obligations.

Association With Financial Statements

.03 An auditor is associated with financial information when the auditor has applied procedures sufficient to permit the auditor to report in accordance with GAAS. Statements on Standards for Accounting and Review Services address the accountant's considerations when the accountant prepares and presents financial statements to the entity or to third parties.

An Audit of Financial Statements

.04 The purpose of an audit is to provide financial statement users with an opinion by the auditor on whether the financial statements are presented fairly, in all material respects, in accordance with an applicable financial reporting framework, which enhances the degree of confidence that intended users can place in the financial statements. An audit conducted in accordance with GAAS and relevant ethical requirements enables the auditor to form that opinion. (Ref: par. .A1)

.05 The financial statements subject to audit are those of the entity, prepared and presented by management of the entity with oversight from those charged with governance. GAAS do not impose responsibilities on management or those charged with governance and do not override laws and regulations that govern their responsibilities. However, an audit in accordance with GAAS is conducted on the premise that management and, when appropriate, those charged with governance have acknowledged certain responsibilities that are fundamental to the conduct of the audit. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities. (Ref: par. .A2–.A13)

.06 As the basis for the auditor's opinion, GAAS require the auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a high, but not absolute, level of assurance. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (that is, the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. Reasonable assurance is not an absolute level of assurance because there are inherent limitations of an audit that result in most of the audit evidence, on which the auditor draws conclusions and bases the auditor's opinion, being persuasive rather than conclusive. (Ref: par. .A32–.A56)

.07 The concept of materiality is applied by the auditor when both planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and uncorrected misstatements, if any, on the financial statements.[1] In general, misstatements, including omissions, are considered to be material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users that are taken based on the financial statements. Judgments about materiality are made in light of surrounding circumstances, and involve both qualitative and quantitative considerations. These judgments are affected by the auditor's perception of the financial information needs of users of the financial statements, and by the size or nature of a misstatement, or both. The auditor's opinion addresses the financial statements as a whole. Therefore, the auditor has no responsibility to plan and perform the audit to obtain reasonable assurance that misstatements, whether caused by fraud or error, that are not material to the financial statements as a whole, are detected. (Ref: par. .A14)

.08 GAAS contain objectives, requirements, and application and other explanatory material that are designed to support the auditor in obtaining

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[1] See section 320, *Materiality in Planning and Performing an Audit*, and section 450, *Evaluation of Misstatements Identified During the Audit*.

reasonable assurance. GAAS require that the auditor exercise professional judgment and maintain professional skepticism throughout the planning and performance of the audit and, among other things,

- identify and assess risks of material misstatement, whether due to fraud or error, based on an understanding of the entity and its environment, including the entity's internal control.
- obtain sufficient appropriate audit evidence about whether material misstatements exist, through designing and implementing appropriate responses to the assessed risks.
- form an opinion on the financial statements, or determine that an opinion cannot be formed, based on an evaluation of the audit evidence obtained.

.09 The form of opinion expressed by the auditor will depend upon the applicable financial reporting framework and any applicable law or regulation.

.10 The auditor also may have certain other communication and reporting responsibilities to users, management, those charged with governance, or parties outside the entity, regarding matters arising from the audit. These responsibilities may be established by GAAS or by applicable law or regulation.[2]

Effective Date

.11 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

Overall Objectives of the Auditor

.12 The overall objectives of the auditor, in conducting an audit of financial statements, are to

a. obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are presented fairly, in all material respects, in accordance with an applicable financial reporting framework; and

b. report on the financial statements, and communicate as required by GAAS, in accordance with the auditor's findings.

.13 In all cases when reasonable assurance cannot be obtained and a qualified opinion in the auditor's report is insufficient in the circumstances for purposes of reporting to the intended users of the financial statements, GAAS require that the auditor disclaim an opinion or withdraw from the engagement, when withdrawal is possible under applicable law or regulation.

Definitions

.14 For purposes of GAAS, the following terms have the meanings attributed as follows:

Applicable financial reporting framework. The financial reporting framework adopted by management and, when appropriate,

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[2] For examples, see section 260, *The Auditor's Communication With Those Charged With Governance*; section 265, *Communicating Internal Control Related Matters Identified in an Audit*; and paragraph .42 of section 240, *Consideration of Fraud in a Financial Statement Audit*.

reporting framework.[5] Section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, addresses engagements in which the auditor issues a report in connection with financial statements prepared in accordance with a special purpose framework.

.A11 Because of the significance of the premise to the conduct of an audit, the auditor is required to obtain the agreement of management and, when appropriate, those charged with governance, that they acknowledge and understand that they have the responsibilities set out in paragraph .A2 as a precondition for accepting the audit engagement.[6]

Considerations Specific to Audits of Governmental Entities

.A12 The requirements for audits of the financial statements of governmental entities may be broader than those of other entities. As a result, the premise, relating to management's responsibilities, on which an audit of the financial statements of a governmental entity is conducted, may include additional responsibilities, such as the responsibility for the execution of transactions and events in accordance with law, regulation, or other authority. (See paragraph .A63.)

.A13 In audits of governmental entities, auditors may have a responsibility under law, regulation, contract, or grant agreement to report to third parties, such as funding agencies or oversight bodies.

Materiality (Ref: par. .07)

Considerations Specific to Audits of Governmental Entities

.A14 For most state or local governmental entities, the applicable financial reporting framework is based on multiple reporting units, and therefore requires the presentation of financial statements for its activities in various reporting units. Consequently, a reporting unit, or aggregation of reporting units, of the governmental entity represents an opinion unit to the auditor. Generally, the auditor expresses or disclaims an opinion on a government's financial statements as a whole by expressing an opinion or disclaiming an opinion on each opinion unit. In this context, the auditor is responsible for the detection of misstatements that are material to an opinion unit within a governmental entity, but is not responsible for the detection of misstatements that are not material to an opinion unit.

Ethical Requirements Relating to an Audit of Financial Statements (Ref: par. .16)

.A15 The auditor is subject to relevant ethical requirements relating to financial statement audit engagements. Ethical requirements consist of the AICPA Code of Professional Conduct together with rules of state boards of accountancy and applicable regulatory agencies that are more restrictive.

.A16 The AICPA Code of Professional Conduct establishes the fundamental principles of professional ethics, which include the following:

- Responsibilities
- The public interest
- Integrity
- Objectivity and independence

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[5] Paragraph .06*a* of section 210, *Terms of Engagement*.

[6] Paragraph .06*b* of section 210.

- Due care
- Scope and nature of services

.A17 In the case of an audit engagement, it is in the public interest and, therefore, required by this section, that the auditor be independent of the entity subject to the audit. The concept of independence refers to both independence in fact and independence in appearance. The auditor's independence from the entity safeguards the auditor's ability to form an audit opinion without being affected by influences that might compromise that opinion. Independence enhances the auditor's ability to act with integrity, to be objective, and to maintain an attitude of professional skepticism. Independence implies an impartiality that recognizes an obligation to be fair not only to management and those charged with governance of an entity but also users of the financial statements who may rely upon the independent auditor's report. Guidance on threats to independence is set forth in the AICPA's *Conceptual Framework for AICPA Independence Standards* (ET sec. 100-1).

.A18 When the auditor is not independent but is required by law or regulation to report on the financial statements, section 705, *Modifications to the Opinion in the Independent Auditor's Report*, applies.

.A19 Due care requires the auditor to discharge professional responsibilities with competence and to have the appropriate capabilities to perform the audit and enable an appropriate auditor's report to be issued.

.A20 QC section 10, *A Firm's System of Quality Control*, sets out the firm's responsibilities to establish and maintain its system of quality control for audit engagements, and to establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements, including those pertaining to independence.[7] Section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, addresses the engagement partner's responsibilities regarding relevant ethical requirements. These include remaining alert for evidence of noncompliance with relevant ethical requirements by members of the engagement team, determining, in consultation with others in the firm as appropriate, the appropriate action if matters come to the engagement partner's attention, through the firm's system of quality control or otherwise, that indicate that members of the engagement team have not complied with relevant ethical requirements, and forming a conclusion on compliance with independence requirements that apply to the audit engagement.[8] Section 220 recognizes that the engagement team is entitled to rely on a firm's system of quality control in meeting its responsibilities with respect to quality control procedures applicable to the individual audit engagement, unless the engagement partner determines that it is inappropriate to do so based on information provided by the firm or other parties.

Considerations Specific to Audits of Governmental Entities

.A21 In addition to the AICPA Code of Professional Conduct and GAAS, *Government Auditing Standards*, which may be required by law, regulation, contract, or grant agreement in audits of governmental entities and entities that receive government awards, set forth relevant ethical principles and auditing standards, including standards on auditor independence, professional judgment, competence, and audit quality control and assurance.

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[7] Paragraphs .21–.25 of QC section 10, *A Firm's System of Quality Control*.

[8] Paragraphs .11–.13 of section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

AU Section 220
Independence

Source: SAS No. 1, section 220.

Issue date, unless otherwise indicated: November, 1972.

.01 The second general standard is:

> The auditor must maintain independence in mental attitude in all matters relating to the audit.

[Revised, November 2006, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 113.]

.02 This standard requires that the auditor be independent; aside from being in public practice (as distinct from being in private practice), he must be without bias with respect to the client since otherwise he would lack that impartiality necessary for the dependability of his findings, however excellent his technical proficiency may be. However, independence does not imply the attitude of a prosecutor but rather a judicial impartiality that recognizes an obligation for fairness not only to management and owners of a business but also to creditors and those who may otherwise rely (in part, at least) upon the independent auditor's report, as in the case of prospective owners or creditors.

.03 It is of utmost importance to the profession that the general public maintain confidence in the independence of independent auditors. Public confidence would be impaired by evidence that independence was actually lacking, and it might also be impaired by the existence of circumstances which reasonable people might believe likely to influence independence. To *be* independent, the auditor must be intellectually honest; to be *recognized* as independent, he must be free from any obligation to or interest in the client, its management, or its owners. For example, an independent auditor auditing a company of which he was also a director might be intellectually honest, but it is unlikely that the public would accept him as independent since he would be in effect auditing decisions which he had a part in making. Likewise, an auditor with a substantial financial interest in a company might be unbiased in expressing his opinion on the financial statements of the company, but the public would be reluctant to believe that he was unbiased. Independent auditors should not only be independent in fact; they should avoid situations that may lead outsiders to doubt their independence.

.04 The profession has established, through the AICPA's Code of Professional Conduct, precepts to guard against the *presumption* of loss of independence. "Presumption" is stressed because the possession of intrinsic independence is a matter of personal quality rather than of rules that formulate certain objective tests. Insofar as these precepts have been incorporated in the profession's code, they have the force of professional law for the independent auditor.

.05 The Securities and Exchange Commission (SEC) has also adopted requirements for independence of auditors who report on financial statements filed with it that differ from the AICPA requirements in certain respects.[1]

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[1] [Footnote deleted, December 2001, to acknowledge the dissolution of the Independence Standard Board.]

.06 The independent auditor should administer his practice within the spirit of these precepts and rules if he is to achieve a proper degree of independence in the conduct of his work.

.07 To emphasize independence from management, many corporations follow the practice of having the independent auditor appointed by the board of directors or elected by the stockholders.

ET Section 100-1

Conceptual Framework for AICPA Independence Standards

Introduction

.01 This conceptual framework describes the risk-based approach to analyzing independence matters that is used by the Professional Ethics Executive Committee (PEEC) of the AICPA when it develops independence standards. Under that approach, a member's relationship with a client is evaluated to determine whether it poses an unacceptable risk to the member's independence. Risk is unacceptable if the relationship would compromise (or would be perceived as compromising by an informed third party having knowledge of all relevant information) the member's professional judgment when rendering an attest service to the client. Key to that evaluation is identifying and assessing the extent to which a threat to the member's independence exists and, if it does, whether it would be reasonable to expect that the threat would compromise the member's professional judgment and, if so, whether it can be effectively mitigated or eliminated. Under the risk-based approach, steps are taken to prevent circumstances that threaten independence from compromising the professional judgments required in the performance of an attest engagement.

.02 Professional standards of the AICPA require independence for all attest engagements. The PEEC bases its independence interpretations and rulings under section 100 on the concepts in this framework. However, in certain circumstances the PEEC has determined that it is appropriate to prohibit or restrict certain relationships notwithstanding the fact that the risk may be at an acceptable level. For example, the PEEC has determined that a covered member should not own even an immaterial direct financial interest in an attest client.

.03 Because this conceptual framework describes the concepts upon which the AICPA's independence interpretations and rulings are based, it may assist AICPA members and others in understanding those interpretations and rulings. In addition, this conceptual framework should be used by members when making decisions on independence matters that are not explicitly addressed by the Code of Professional Conduct. Under no circumstances, however, may the framework be used to overcome prohibitions or requirements contained in the independence interpretations and rulings.

.04 The risk-based approach entails evaluating the risk that the member would not be independent or would be perceived by a reasonable and informed third party having knowledge of all relevant information as not being independent. That risk must be reduced to an acceptable level to conclude that a member is independent under the concepts in this framework. Risk is at an acceptable level when threats are at an acceptable level, either because of the types of threats and their potential effect, or because safeguards have sufficiently mitigated or eliminated the threats. Threats are at an acceptable level when it is not reasonable to expect that the threat would compromise professional judgment.

.05 The risk-based approach involves the following steps.

a. Identifying and evaluating threats to independence—Identify and evaluate threats, both individually and in the aggregate, because threats can have a cumulative effect on a member's independence. Where threats are identified but, due to the types of threats and their potential effects, such threats are considered to be at an acceptable level (that is, it is not reasonable to expect that the threats would compromise professional judgment), the consideration of safeguards is not required. If identified threats are not considered to be at an acceptable level, safeguards should be considered as described in paragraph .05*b*.

b. Determining whether safeguards already eliminate or sufficiently mitigate identified threats and whether threats that have not yet been mitigated can be eliminated or sufficiently mitigated by safeguards—Different safeguards can mitigate or eliminate different types of threats, and one safeguard can mitigate or eliminate several types of threats simultaneously. When threats are sufficiently mitigated by safeguards, the threats' potential to compromise professional judgment is reduced to an acceptable level. A threat has been sufficiently mitigated by safeguards if, after application of the safeguards, it is not reasonable to expect that the threat would compromise professional judgment.[1]

c. If no safeguards are available to eliminate an unacceptable threat or reduce it to an acceptable level, independence would be considered impaired.

Definitions

.06 *Independence* is defined as:

a. *Independence of mind*—The state of mind that permits the performance of an attest service without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.

b. *Independence in appearance*—The avoidance of circumstances that would cause a reasonable and informed third party, having knowledge of all relevant information, including safeguards[2] applied, to reasonably conclude that the integrity, objectivity, or professional skepticism of a firm or a member of the attest engagement team had been compromised.

.07 This definition reflects the longstanding professional requirement that members who provide services to entities for which independence is required be independent both in fact and in appearance.[3] The state of mind of a member who is independent "in fact" assists the member in performing an attest engagement in an objective manner. Accordingly, independence of mind reflects the longstanding requirement that members be independent in fact.

.08 This definition is used as part of the risk-based approach to analyze independence. Because the risk-based approach requires judgment, the definition should not be interpreted as an absolute. For example, the phrase "without

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[1] In cases where threats to independence are not at an acceptable level, thereby requiring the application of safeguards, the threats identified and the safeguards applied to eliminate the threats or reduce them to an acceptable level should be documented as required under "Other Considerations" of Interpretation 101-1, *Interpretation of Rule 101* [section 101.02].

[2] The term *safeguards* is defined in paragraph .20.

[3] Section 55, *Article IV—Objectivity and Independence*, states, "A member in public practice should be independent in fact and appearance when providing auditing and other attestation services."

being affected by influences that compromise professional judgment" is not intended to convey that the member must be free of any and all influences that might compromise objective judgment. Instead, a determination must be made about whether such influences, if present, create an unacceptable risk that a member would not act with integrity and exercise objectivity and professional skepticism in the conduct of a particular engagement, or would be perceived as not being able to do so by a reasonable and informed third party that has knowledge of all relevant information.

.09 *Impair*—For purposes of this framework, *impair* means to effectively extinguish (independence). When a member's independence is impaired, the member is not independent.

.10 *Threats*—Threats to independence are circumstances that could impair independence. Whether independence is impaired depends on the nature of the threat, whether it would be reasonable to expect that the threat would compromise the member's professional judgment and, if so, the specific safeguards applied to reduce or eliminate the threat, and the effectiveness of those safeguards as described in paragraph .21.

.11 Threats might not involve violations of existing interpretations or rulings. For example, the circumstance described in paragraph .18*b* of this framework is permissible in limited instances under current AICPA independence interpretations and rulings.

.12 Many different circumstances (or combinations of circumstances) can create threats to independence. It is impossible to identify every situation that creates a threat. However, seven broad categories of threats should always be evaluated when threats to independence are being identified and assessed. They are self-review, advocacy, adverse interest, familiarity, undue influence, financial self-interest, and management participation threats The following paragraphs define and provide examples, which are not all-inclusive, of each of these threat categories. Some of these examples are the subject of independence interpretations and rulings contained in the Code of Professional Conduct.

.13 *Self-review threat*—Members reviewing as part of an attest engagement evidence that results from their own, or their firm's, nonattest work such as, preparing source documents used to generate the client's financial statements

.14 *Advocacy threat*—Actions promoting an attest client's interests or position.[4]

a. Promoting the client's securities as part of an initial public offering

b. Representing a client in U.S. tax court

.15 *Adverse interest threat*—Actions or interests between the member and the client that are in opposition, such as, commencing, or the expressed intention to commence, litigation by either the client or the member against the other.

.16 *Familiarity threat*—Members having a close or longstanding relationship with an attest client or knowing individuals or entities (including by reputation) who performed nonattest services for the client.

a. A member of the attest engagement team whose spouse is in a key position at the client, such as the client's chief executive officer

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[4] This threat does not arise from testifying as a fact witness or defending the results of a professional service that the member performed for the client.

b. A partner of the firm who has provided the client with attest services for a prolonged period

c. A member who performs insufficient audit procedures when reviewing the results of a nonattest service because the service was performed by the member's firm

d. A member of the firm having recently been a director or officer of the client

e. A member of the attest engagement team whose close friend is in a key position at the client

.17 *Undue influence threat*—Attempts by an attest client's management or other interested parties to coerce the member or exercise excessive influence over the member.

a. A threat to replace the member or the member's firm over a disagreement with client management on the application of an accounting principle

b. Pressure from the client to reduce necessary audit procedures for the purpose of reducing audit fees

c. A gift from the client to the member that is other than clearly insignificant to the member

.18 *Financial self-interest threat*—Potential benefit to a member from a financial interest in, or from some other financial relationship with, an attest client.

a. Having a direct financial interest or material indirect financial interest in the client

b. Having a loan from the client, from an officer or director of the client, or from an individual who owns 10 percent or more of the client's outstanding equity securities

c. Excessive reliance on revenue from a single attest client

d. Having a material joint venture or other material joint business arrangement with the client

.19 *Management participation threat*—Taking on the role of client management or otherwise performing management functions on behalf of an attest client.

a. Serving as an officer or director of the client

b. Establishing and maintaining internal controls for the client

c. Hiring, supervising, or terminating the client's employees

.20 *Safeguards*—Controls that eliminate or reduce threats to independence. Safeguards range from partial to complete prohibitions of the threatening circumstance to procedures that counteract the potential influence of a threat. The nature and extent of the safeguards to be applied depend on many factors, including the size of the firm and whether the client is a public interest entity. To be effective, safeguards should eliminate or reduce the threat to an acceptable level.

Solely for the purpose of this conceptual framework, the following entities are considered to be public interest entities: (*a*) all listed entities [5] and (*b*) any entity for which an audit is required by regulation or legislation to be conducted in

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[5] Including entities that are outside the United States whose shares, stock, or debt are quoted or listed on a recognized stock exchange or marketed under the regulations of a recognized stock exchange or other equivalent body. [Footnote revised September 2011, effective November 30, 2011.]

compliance with the same independence requirements that apply to an audit of listed entities (for example, requirements of the Securities and Exchange Commission, the Public Company Accounting Oversight Board, or other similar regulators or standard setters).[6, 7]

.21 The effectiveness of a safeguard depends on many factors, including those listed here:

a. The facts and circumstances specific to a particular situation

b. The proper identification of threats

c. Whether the safeguard is suitably designed to meet its objectives

d. The party or parties that will be subject to the safeguard

e. How the safeguard is applied

f. The consistency with which the safeguard is applied

g. Who applies the safeguard

.22 There are three broad categories of safeguards. The relative importance of a safeguard depends on its appropriateness in light of the facts and circumstances.

a. Safeguards created by the profession, legislation, or regulation

b. Safeguards implemented by the attest client

c. Safeguards implemented by the firm, including policies and procedures to implement professional and regulatory requirements

.23 Examples of various safeguards within each category are presented in the following paragraphs. The examples are not intended to be all-inclusive and, conversely, the examples of safeguards implemented by the attest client and within the firm's own systems and procedures may not all be present in each instance. In addition, threats may be sufficiently mitigated through the application of other safeguards not specifically identified herein.

.24 *Examples of safeguards created by the profession, legislation, or regulation*

a. Education and training requirements on independence and ethics rules for new professionals

b. Continuing education requirements on independence and ethics

c. Professional standards and monitoring and disciplinary processes

d. External review of a firm's quality control system

e. Legislation governing the independence requirements of the firm

f. Competency and experience requirements for professional licensure

.25 *Examples of safeguards implemented by the attest client that would operate in combination with other safeguards*

a. The attest client has personnel with suitable skill, knowledge, and/or experience who make managerial decisions with respect to the delivery of nonattest services by the member to the attest client

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[6] Members may wish to consider whether additional entities should also be treated as public interest entities because they have a large number and wide range of stakeholders. Factors to be considered may include (*a*) the nature of the business, such as the holding of assets in a fiduciary capacity for a large number of stakeholders; (*b*) size; and (*c*) number of employees. [Footnote added September 2011, effective November 30, 2011.]

[7] Members should refer to the independence regulations of authoritative regulatory bodies when a member performs attest services and is required to be independent of the client under such regulations. [Footnote added September 2011, effective November 30, 2011.]

b. A tone at the top that emphasizes the attest client's commitment to fair financial reporting

c. Policies and procedures that are designed to achieve fair financial reporting

d. A governance structure, such as an active audit committee, that is designed to ensure appropriate decision making, oversight, and communications regarding a firm's services

e. Policies that dictate the types of services that the entity can hire the audit firm to provide without causing the firm's independence to be considered impaired

.26 *Examples of safeguards implemented by the firm*

a. Firm leadership that stresses the importance of independence and the expectation that members of attest engagement teams will act in the public interest

b. Policies and procedures that are designed to implement and monitor quality control in attest engagements

c. Documented independence policies regarding the identification of threats to independence, the evaluation of the significance of those threats, and the identification and application of safeguards that can eliminate the threats or reduce them to an acceptable level

d. Internal policies and procedures that are designed to monitor compliance with the firm's independence policies and procedures

e. Policies and procedures that are designed to identify interests or relationships between the firm or its partners and professional staff and attest clients

f. The use of different partners and engagement teams that have separate reporting lines in the delivery of permitted nonattest services to an attest client, particularly when the separation between reporting lines is significant

g. Training on and timely communication of a firm's policies and procedures, and any changes to them, for all partners and professional staff

h. Policies and procedures that are designed to monitor the firm or partner's reliance on revenue from a single client and, if necessary, cause action to be taken to address excessive reliance

i. Designating someone from senior management as the person who is responsible for overseeing the adequate functioning of the firm's quality control system

j. A means of informing partners and professional staff of attest clients and related entities from which they must be independent

k. A disciplinary mechanism that is designed to promote compliance with policies and procedures

l. Policies and procedures that are designed to empower staff to communicate to senior members of the firm any engagement issues that concern them without fear of retribution

m. Policies and procedures relating to independence communications with audit committees or others charged with client governance

n. Discussing independence issues with the audit committee or others responsible for the client's governance *o.* Disclosures to the audit committee (or others responsible for the client's governance) regarding the nature of the services that are or will be provided and the extent of the fees charged or to be charged

p. The involvement of another professional accountant who (1) reviews the work that is done for an attest client or (2) otherwise advises the attest engagement team (This individual could be someone from outside the firm or someone from within the firm who is not otherwise associated with the attest engagement.)

q. Consultation on engagement issues with an interested third party, such as a committee of independent directors, a professional regulatory body, or another professional accountant

r. Rotation of senior personnel who are part of the attest engagement team

s. Policies and procedures that are designed to ensure that members of the attest engagement team do not make or assume responsibility for management decisions for the attest client

t. The involvement of another firm to perform part of the attest engagement

u. The involvement of another firm to reperform a nonattest service to the extent necessary to enable it to take responsibility for that service

v. The removal of an individual from an attest engagement team when that individual's financial interests or relationships pose a threat to independence

w. A consultation function that is staffed with experts in accounting, auditing, independence, and reporting matters who can help attest engagement teams (i.) assess issues when guidance is unclear, or when the issues are highly technical or require a great deal of judgment and (ii.) resist undue pressure from a client when the engagement team disagrees with the client about such issues

x. Client acceptance and continuation policies that are designed to prevent association with clients that pose an unacceptable threat to the member's independence

y. Policies that preclude audit partners from being directly compensated for selling nonattest services to the audit client

[Revised September 2011, effective November 30, 2011. Issued April 2006, effective April 30, 2007, with earlier application encouraged, by the Professional Ethics Executive Committee.]

ET Section 101

Independence

.01 Rule 101—Independence A member in public practice shall be independent in the performance of professional services as required by standards promulgated by bodies designated by council.

[As adopted January 12, 1988.]

Interpretations under Rule 101—Independence

In performing an attest engagement, a member should consult the rules of his or her state board of accountancy, his or her state CPA society, the Public Company Accounting Oversight Board and the U.S. Securities and Exchange Commission (SEC) if the member's report will be filed with the SEC, the U.S. Department of Labor (DOL) if the member's report will be filed with the DOL, the Government Accountability Office (GAO) if law, regulation, agreement, policy or contract requires the member's report to be filed under GAO regulations, and any organization that issues or enforces standards of independence that would apply to the member's engagement. Such organizations may have independence requirements or rulings that differ from (for example, may be more restrictive than) those of the AICPA.

.02 101-1—Interpretation of Rule 101 Independence shall be considered to be impaired if:

A. During the **period of the professional engagement** [*] a **covered member**

1. Had or was committed to acquire any direct or material indirect financial interest in the **client**.
2. Was a trustee of any trust or executor or administrator of any estate if such trust or estate had or was committed to acquire any direct or material indirect financial interest in the client and
   - (i) The covered member (individually or with others) had the authority to make investment decisions for the trust or estate; or
   - (ii) The trust or estate owned or was committed to acquire more than 10 percent of the client's outstanding equity securities or other ownership interests; or
   - (iii) The value of the trust's or estate's holdings in the client exceeded 10 percent of the total assets of the trust or estate.
3. Had a **joint closely held investment** that was material to the covered member.
4. Except as specifically permitted in Interpretation No. 101-5, "Loans From Financial Institution Clients and Related Terminology" [sec. 101 par. .07], had any **loan** to or from the client, any officer or director of the client, or any individual owning 10 percent or more of the client's outstanding equity securities or other ownership interests.

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[*] Terms shown in **boldface** type upon first usage in this interpretation are defined in section 92, *Definitions*. [Footnote added, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

B. During the period of the professional engagement, a **partner** or professional employee of the **firm**, his or her **immediate family**, or any group of such persons acting together owned more than 5 percent of a client's outstanding equity securities or other ownership interests.

C. During the period covered by the **financial statements** or during the period of the professional engagement, a firm, or partner or professional employee of the firm was simultaneously associated with the client as a(n)

1. Director, officer, or employee, or in any capacity equivalent to that of a member of management;
2. Promoter, underwriter, or voting trustee; or
3. Trustee for any pension or profit-sharing trust of the client.

Transition Period for Certain Business and Employment Relationships

A business or employment relationship with a client that impairs independence under Interpretation No. 101-1, "Interpretation of Rule 101" [sec. 101 par. .02(C)], and that existed as of November 2001, will not be deemed to impair independence provided such relationship was permitted under Rule 101 [sec. 101 par. .01], and its interpretations and rulings as of November 2001, and the individual severed that relationship on or before May 31, 2002.

Application of the Independence Rules to Covered Members Formerly Employed by a Client or Otherwise Associated With a Client

A firm's independence would be impaired if a covered member who was formerly [1] (*a*) employed by a client or (*b*) associated with a client as a(n) officer, director, promoter, underwriter, voting trustee, or trustee for a pension or profit sharing trust of the client

a. fails to disassociate himself or herself from the client prior to becoming a covered member. Disassociation includes the following:

i. Ceasing to participate in all employee health and welfare plans sponsored by the client, unless the client is legally required to allow the covered member to participate in the plan (for example, Consolidated Omnibus Budget Reconciliation Act (COBRA)) and the covered member pays 100 percent of his or her portion of the cost of participation on a current basis.

ii. Ceasing to participate in all other employee benefit plans by liquidating or transferring all vested benefits in the client's defined benefit plans, defined contribution plans, share-based compensation arrangements,[2] deferred compensation plans, and other similar arrangements at the earliest date permitted under the plan.[3]

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[1] This provision applies once the individual has terminated his or her relationship with the client and is no longer employed by, or otherwise associated with, the client. See item (C) of Interpretation No. 101-1, "Interpretation of Rule 101" (par. .02), for matters involving a partner or professional employee who is simultaneously employed by, or otherwise associated with, the client and the firm. [Footnote moved and revised by the Professional Ethics Executive Committee, March 2010.]

[2] As defined in the Financial Accounting Standards Board *Accounting Standards Codification* glossary under the term *share-based payment arrangements*. [Footnote moved and revised by the Professional Ethics Executive Committee, March 2010.]

[3] When the member is a former employee of a governmental unit that is one of the sponsors of an employee benefit plan, the member may continue to participate in the governmental plan if

(continued)

- preparing source documents[17] in electronic or other form evidencing the occurrence of a transaction.
- having custody of client assets.
- deciding which recommendations of the member or other third parties to implement or prioritize.
- reporting to those in charge of governance on behalf of management.
- serving as a client's stock transfer or escrow agent, registrar, general counsel, or its equivalent.
- accepting responsibility for the management of a client's project.
- accepting responsibility for the preparation and fair presentation of the client's financial statements in accordance with the applicable financial reporting framework.
- accepting responsibility for designing, implementing, or maintaining internal control.[18]
- performing ongoing evaluations of the client's internal control as part of its monitoring activities.

Specific Examples of Nonattest Services

The examples in the following table identify the effect that performance of certain nonattest services for an attest client can have on a member's independence. These examples presume that the general requirements in the previous section, "General Requirements for Performing Nonattest Services", have been met and are not intended to be all-inclusive of the types of nonattest services performed by members.

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[17] Source documents are the documents upon which evidence of an accounting transaction are initially recorded. Source documents are often followed by the creation of many additional records and reports, which do not, however, qualify as initial recordings. Examples of source documents are purchase orders, payroll time cards, and customer orders. [Footnote renumbered by the revision of Interpretation No. 101-2, April 2003. Footnote subsequently renumbered and revised, September 2003, by the Professional Ethics Executive Committee. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

[18] [Footnote added, effective July 31, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of Interpretation No. 101-1, March 2010. Footnote deleted, effective August 31, 2012, by the Professional Ethics Executive Committee.]

Impact on Independence of Performance of Nonattest Services

Type of Nonattest Service	*Independence Would Not Be Impaired*	*Independence Would Be Impaired*
Bookkeeping	• Record transactions for which management has determined or approved the appropriate account classification, or post coded transactions to a client's general ledger. • Prepare financial statements based on information in the trial balance. • Post client-approved entries to a client's trial balance. • Prepare a reconciliation (for example, bank, accounts receivable, and so forth) that identifies reconciling items for the client's evaluation. • Propose standard, adjusting, or correcting journal entries or other changes affecting the financial statements to the client provided the client reviews the entries and the member is satisfied that management understands the nature of the proposed entries and the impact the entries have on the financial statements.	• Determine or change journal entries, account codings or classification for transactions, or other accounting records without obtaining client approval. • Authorize or approve transactions. • Prepare source documents. • Make changes to source documents without client approval.
Nontax disbursement	• Using payroll time records provided and approved by the client, generate unsigned checks, or process client's payroll. • Transmit client-approved payroll or other disbursement information to a financial institution provided the client has authorized the member to make the transmission and has made arrangements for the financial institution to limit the corresponding individual payments as to amount and payee. In addition, once transmitted, the client must authorize the financial institution to process the information.[19]	• Accept responsibility to authorize payment of client funds, electronically or otherwise, except as specifically provided for with respect to electronic payroll tax payments. • Accept responsibility to sign or cosign client checks, even if only in emergency situations. • Maintain a client's bank account or otherwise have custody of a client's funds or make credit or banking decisions for the client. • Approve vendor invoices for payment

(continued)

[19] [Footnote renumbered by the revision of Interpretation No. 101-2, April 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, September, 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote deleted by the Professional Ethics Executive Committee, February 2007. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

Type of Nonattest Service	*Independence Would Not Be Impaired*	*Independence Would Be Impaired*
Benefit plan administration[20]	• Communicate summary plan data to plan trustee. • Advise client management regarding the application or impact of provisions of the plan document. • Process transactions (e.g., investment/ benefit elections or increase/decrease contributions to the plan; data entry; participant confirmations; and processing of distributions and loans) initiated by plan participants through the member's electronic medium, such as an interactive voice response system or Internet connection or other media. • Prepare account valuations for plan participants using data collected through the member's electronic or other media. • Prepare and transmit participant statements to plan participants based on data collected through the member's electronic or other medium.	• Make policy decisions on behalf of client management. • When dealing with plan participants, interpret the plan document on behalf of management without first obtaining management's concurrence. • Make disbursements on behalf of the plan. • Have custody of assets of a plan. • Serve a plan as a fiduciary as defined by ERISA.
Investment—advisory or management	• Recommend the allocation of funds that a client should invest in various asset classes, depending upon the client's desired rate of return, risk tolerance, etc. • Perform recordkeeping and reporting of client's portfolio balances including providing a comparative analysis of the client's investments to third-party benchmarks. • Review the manner in which a client's portfolio is being managed by investment account managers, including determining whether the managers are (1) following the guidelines of the client's investment policy statement; (2) meeting the client's investment objectives; and (3) conforming to the client's stated investment styles. • Transmit a client's investment selection to a broker-dealer or equivalent provided the client has authorized the broker-dealer or equivalent to execute the transaction.	• Make investment decisions on behalf of client management or otherwise have discretionary authority over a client's investments. • Execute a transaction to buy or sell a client's investment. • Have custody of client assets, such as taking temporary possession of securities purchased by a client.

[20] When auditing plans subject to the Employee Retirement Income Security Act, Department of Labor regulations, which may be more restrictive, must be followed. [Footnote renumbered by the revision of Interpretation No. 101-2, April 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, September 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

Type of Nonattest Service	*Independence Would Not Be Impaired*	*Independence Would Be Impaired*
Corporate finance—consulting or advisory	• Assist in developing corporate strategies. • Assist in identifying or introducing the client to possible sources of capital that meet the client's specifications or criteria. • Assist in analyzing the effects of proposed transactions including providing advice to a client during negotiations with potential buyers, sellers, or capital sources. • Assist in drafting an offering document or memorandum. • Participate in transaction negotiations in an advisory capacity. • Be named as a financial adviser in a client's private placement memoranda or offering documents.	• Commit the client to the terms of a transaction or consummate a transaction on behalf of the client. • Act as a promoter, underwriter, broker-dealer, or guarantor of client securities, or distributor of private placement memoranda or offering documents. • Maintain custody of client securities.
Executive or employee search	• Recommend a position description or candidate specifications. • Solicit and perform screening of candidates and recommend qualified candidates to a client based on the client-approved criteria (e.g., required skills and experience). • Participate in employee hiring or compensation discussions in an advisory capacity.	• Commit the client to employee compensation or benefit arrangements. • Hire or terminate client employees.
Business risk consulting	• Provide assistance in assessing the client's business risks and control processes. • Recommend a plan for making improvements to a client's control processes and assist in implementing these improvements.	• Make or approve business risk decisions. • Present business risk considerations to the board or others on behalf of management.
Information systems—design, installation or integration	• Install or integrate a client's financial information system that was not designed or developed by the member (for example, an off-the-shelf accounting package). • Assist in setting up the client's chart of accounts and financial statement format with respect to the client's financial information system. • Design, develop, install, or integrate a client's information system that is unrelated to the client's financial statements or accounting records. • Provide training and instruction to client employees on an information and control system. • Perform network maintenance, such as updating virus protection, applying routine updates and patches, or configuring user settings, consistent with management's request.	• Design or develop a client's financial information system. • Make other than insignificant modifications to source code underlying a client's existing financial information system. • Supervise client personnel in the daily operation of a client's information system. • Operate a client's local area network system.

PCAOB Rule 3520. Auditor Independence

A registered public accounting firm and its associated persons must be independent of the firm's audit client throughout the audit and professional engagement period.

Note 1: Under Rule 3520, a registered public accounting firm or associated person's independence obligation with respect to an audit client encompasses not only an obligation to satisfy the independence criteria applicable to the engagement set out in the rules and standards of the PCAOB, but also an obligation to satisfy all other independence criteria applicable to the engagement, including the independence criteria set out in the rules and regulations of the Commission under the federal securities laws.

Note 2: Rule 3520 applies only to those associated persons of a registered public accounting firm required to be independent of the firm's audit client by standards, rules or regulations of the Board or Commission or other applicable independence criteria.

[Effective pursuant to SEC Release No. 34-53677, File No. PCAOB-2006-01 (April 19, 2006); and SEC Release No. 34-72087, File No. PCAOB-2013-03 (May 2, 2014)]

PCAOB Rule 5300. Sanctions

(a) Sanctions in Proceedings Instituted Pursuant to Rule 5200(a)(1) or Rule 5200(a)(2)

If the Board finds, based on all of the facts and circumstances, that a registered public accounting firm or associated person thereof has engaged in any act or practice, or omitted to act, in violation of the Act, the Rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under the Act, or professional standards, the Board may impose such disciplinary or remedial sanctions as it determines appropriate, subject to the applicable limitations under Section 105(c)(5) of the Act, including -

(1) temporary suspension or permanent revocation of registration;

(2) temporary or permanent suspension or bar of a person from further association with any registered public accounting firm;

(3) temporary or permanent limitation on the activities, functions or operations of such firm or person (other than in connection with required additional professional education or training);

Note: Limitations on the activities, functions or operations of a firm may include prohibiting a firm from accepting new audit clients for a period of time, requiring a firm to assign a reviewer or supervisor to an associated person, requiring a firm to terminate one or more audit engagements, and requiring a firm to make functional changes in supervisory personnel organization and/or in engagement team organization.

(4) a civil money penalty for each such violation, in an amount not to exceed the maximum amount authorized by Sections 105(c)(4)(D)(i) and 105(c)(4)(D)(ii) of the Act, including penalty inflation adjustments published in the Code of Federal Regulations at 17 C.F.R. § 201 Subpart E;

(5) censure;

(6) require additional professional education or training;

(7) require a registered public accounting firm to engage an independent monitor, subject to the approval of the Board, to observe and report on the firm's compliance with the Act, the Rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, or professional standards;

(8) require a registered public accounting firm to engage counsel or another consultant to design policies to effectuate compliance with the Act, the Rules of the Board, the

provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, or professional standards;

(9) require a registered public accounting firm, or a person associated with such a firm, to adopt or implement policies, or to undertake other actions, to improve audit quality or to effectuate compliance with the Act, the Rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, or professional standards; and

(10) require a registered public accounting firm to obtain an independent review and report on one or more engagements.

(b) Sanctions in Proceedings Instituted Pursuant to Rule 5200(a)(3)

If the Board finds, based on all of the facts and circumstances, that a registered public accounting firm, or a person associated with such a firm, has failed to comply with an accounting board demand, has given false testimony or has otherwise failed to cooperate in an investigation, the Board may impose such disciplinary or remedial sanctions as it determines appropriate, including -

(1) the sanctions described in subparagraphs (1) - (5) of paragraph (a) of this Rule;

(2) requiring a registered public accounting firm to engage a special master or independent monitor, appointed by the hearing officer, to monitor and report on the firms' compliance with an accounting board demand or with future accounting board demands; or

(3) authorizing the hearing officer to retain jurisdiction to monitor compliance with an accounting board demand or with future account board demands and to rule on future disputes, if any, related to such demands.

Note 1: Rule 5300 does not preclude the imposition of any sanction, on consent, in the context of a settlement, notwithstanding that the sanction is not listed in the Rule.

Note 2: The maximum penalty amounts authorized by the Act are periodically adjusted for inflation by the Commission, pursuant to the Federal Civil Penalties Inflation Adjustment Act of 1990, as amended by the Debt Collection Improvement Act of 1996, and vary depending upon the date the violation occurs. The maximum penalty amounts are published at 17 C.F.R. § 201 Subpart E.

[Effective pursuant to SEC Release No. 34-49704, File No. PCAOB-2003-07 (May 14, 2004); and SEC Release No. 34-72087, File No. PCAOB-2013-03 (May 2, 2014)] such person directly, or indirectly through one or more intermediaries.

(y) *Totally held subsidiary.* The term *totally held subsidiary* means a subsidiary (1) substantially all of whose outstanding equity securities are owned by its parent and/or the parent's other totally held subsidiaries, and (2) which is not indebted to any person other than its parent and/or the parent's other totally held subsidiaries, in an amount which is material in relation to the particular subsidiary, excepting indebtedness incurred in the ordinary course of business which is not overdue and which matures within 1 year from the date of its creation, whether evidenced by securities or not. Indebtedness of a subsidiary which is secured by its parent by guarantee, pledge, assignment, or otherwise is to be excluded for purposes of paragraph (x)(2) of this section.

(z) *Voting shares.* The term *voting shares* means the sum of all rights, other than as affected by events of default, to vote for election of directors and/or the sum of all interests in an unincorporated person.

(aa) *Wholly owned subsidiary.* The term *wholly owned subsidiary* means a subsidiary substantially all of whose outstanding voting shares are owned by its parent and/or the parent's other wholly owned subsidiaries.

(bb) *Summarized financial information.* (1) Except as provided in paragraph (aa)(2), *summarized financial information* referred to in this regulation shall mean the presentation of summarized information as to the assets, liabilities and results of operations of the entity for which the information is required. Summarized financial information shall include the following disclosures:

(i) Current assets, noncurrent assets, current liabilities, noncurrent liabilities, and, when applicable, redeemable preferred stocks (see § 210.5–02.27) and noncontrolling interests (for specialized industries in which classified balance sheets are normally not presented, information shall be provided as to the nature and amount of the majority components of assets and liabilities);

(ii) Net sales or gross revenues, gross profit (or, alternatively, costs and expenses applicable to net sales or gross revenues), income or loss from continuing operations before extraordinary items and cumulative effect of a change in accounting principle, net income or loss, and net income or loss attributable to the entity (for specialized industries, other information may be substituted for sales and related costs and expenses if necessary for a more meaningful presentation); and

(2) Summarized financial information for unconsolidated subsidiaries and 50 percent or less owned persons referred to in and required by § 210.10–01(b) for interim periods shall include the information required by paragraph (aa)(1)(ii) of this section.

[37 FR 14593, July 21, 1972]

EDITORIAL NOTE: For FEDERAL REGISTER citations affecting § 210.1–02, see the List of CFR Sections Affected, which appears in the Finding Aids section of the printed volume and at www.fdsys.gov.

QUALIFICATIONS AND REPORTS OF ACCOUNTANTS

SOURCE: Sections 210.2–01 through 210.2–05 appear at 37 FR 14594, July 21, 1972, unless otherwise noted.

§ 210.2–01 Qualifications of accountants.

Preliminary Note to § 210.2–01

1. Section 210.2–01 is designed to ensure that auditors are qualified and independent of their audit clients both in fact and in appearance. Accordingly, the rule sets forth restrictions on financial, employment, and business relationships between an accountant and an audit client and restrictions on an accountant providing certain non-audit services to an audit client.

2. Section 210.2–01(b) sets forth the general standard of auditor independence. Paragraphs (c)(1) to (c)(5) reflect the application of the general standard to particular circumstances. The rule does not purport to, and the Commission could not, consider all circumstances that raise independence concerns, and these are subject to the general standard in § 210.2–01(b). In considering this standard, the Commission looks in the first instance to whether a relationship or the provision of a service: creates a mutual or conflicting interest between the accountant and the audit client; places the accountant in the position of auditing his or her own work; results in the accountant acting as management or an employee of the audit client; or places the accountant in a position of being an advocate for the audit client.

3. These factors are general guidance only and their application may depend on particular facts and circumstances. For that reason, §210.2–01 provides that, in determining whether an accountant is independent, the Commission will consider all relevant facts and circumstances. For the same reason, registrants and accountants are encouraged to consult with the Commission's Office of the Chief Accountant before entering into relationships, including relationships involving the provision of services, that are not explicitly described in the rule.

(a) The Commission will not recognize any person as a certified public accountant who is not duly registered and in good standing as such under the laws of the place of his residence or principal office. The Commission will not recognize any person as a public accountant who is not in good standing and entitled to practice as such under the laws of the place of his residence or principal office.

(b) The Commission will not recognize an accountant as independent, with respect to an audit client, if the accountant is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is not, capable of exercising objective and impartial judgment on all issues encompassed within the accountant's engagement. In determining whether an accountant is independent, the Commission will consider all relevant circumstances, including all relationships between the accountant and the audit client, and not just those relating to reports filed with the Commission.

(c) This paragraph sets forth a non-exclusive specification of circumstances inconsistent with paragraph (b) of this section.

(1) *Financial relationships.* An accountant is not independent if, at any point during the audit and professional engagement period, the accountant has a direct financial interest or a material indirect financial interest in the accountant's audit client, such as:

(i) *Investments in audit clients.* An accountant is not independent when:

(A) The accounting firm, any covered person in the firm, or any of his or her immediate family members, has any direct investment in an audit client, such as stocks, bonds, notes, options, or other securities. The term *direct investment* includes an investment in an audit client through an intermediary if:

(*1*) The accounting firm, covered person, or immediate family member, alone or together with other persons, supervises or participates in the intermediary's investment decisions or has control over the intermediary; or

(*2*) The intermediary is not a diversified management investment company, as defined by section 5(b)(1) of the Investment Company Act of 1940, 15 U.S.C. 80a–5(b)(1), and has an investment in the audit client that amounts to 20% or more of the value of the intermediary's total investments.

(B) Any partner, principal, shareholder, or professional employee of the accounting firm, any of his or her immediate family members, any close family member of a covered person in the firm, or any group of the above persons has filed a Schedule 13D or 13G (17 CFR 240.13d–101 or 240.13d–102) with the Commission indicating beneficial ownership of more than five percent of an audit client's equity securities or controls an audit client, or a close family member of a partner, principal, or shareholder of the accounting firm controls an audit client.

(C) The accounting firm, any covered person in the firm, or any of his or her immediate family members, serves as voting trustee of a trust, or executor of an estate, containing the securities of an audit client, unless the accounting firm, covered person in the firm, or immediate family member has no authority to make investment decisions for the trust or estate.

(D) The accounting firm, any covered person in the firm, any of his or her immediate family members, or any group of the above persons has any material indirect investment in an audit client. For purposes of this paragraph, the term *material indirect investment* does not include ownership by any covered person in the firm, any of his or her immediate family members, or any group of the above persons of 5% or less of the outstanding shares of a diversified management investment company, as defined by section 5(b)(1) of the Investment Company Act of 1940, 15 U.S.C. 80a–5(b)(1), that invests in an audit client.

(E) The accounting firm, any covered person in the firm, or any of his or her immediate family members:

(*1*) Has any direct or material indirect investment in an entity where:

(*i*) An audit client has an investment in that entity that is material to the audit client and has the ability to exercise significant influence over that entity; or

(*ii*) The entity has an investment in an audit client that is material to that entity and has the ability to exercise significant influence over that audit client;

(*2*) Has any material investment in an entity over which an audit client has the ability to exercise significant influence; or

(*3*) Has the ability to exercise significant influence over an entity that has the ability to exercise significant influence over an audit client.

(ii) *Other financial interests in audit client.* An accountant is not independent when the accounting firm, any covered person in the firm, or any of his or her immediate family members has:

(A) *Loans/debtor-creditor relationship.* Any loan (including any margin loan) to or from an audit client, or an audit client's officers, directors, or record or beneficial owners of more than ten percent of the audit client's equity securities, except for the following loans obtained from a financial institution under its normal lending procedures, terms, and requirements:

(*1*) Automobile loans and leases collateralized by the automobile;

(*2*) Loans fully collateralized by the cash surrender value of an insurance policy;

(*3*) Loans fully collateralized by cash deposits at the same financial institution; and

(*4*) A mortgage loan collateralized by the borrower's primary residence provided the loan was not obtained while the covered person in the firm was a covered person.

(B) *Savings and checking accounts.* Any savings, checking, or similar account at a bank, savings and loan, or similar institution that is an audit client, if the account has a balance that exceeds the amount insured by the Federal Deposit Insurance Corporation or any similar insurer, except that an accounting firm account may have an uninsured balance provided that the likelihood of the bank, savings and loan, or similar institution experiencing financial difficulties is remote.

(C) *Broker-dealer accounts.* Brokerage or similar accounts maintained with a broker-dealer that is an audit client, if:

(*1*) Any such account includes any asset other than cash or securities (within the meaning of ''security'' provided in the Securities Investor Protection Act of 1970 (''SIPA'') (15 U.S.C. 78aaa *et seq.*));

(*2*) The value of assets in the accounts exceeds the amount that is subject to a Securities Investor Protection Corporation advance, for those accounts, under Section 9 of SIPA (15 U.S.C. 78fff-3); or

(*3*) With respect to non-U.S. accounts not subject to SIPA protection, the value of assets in the accounts exceeds the amount insured or protected by a program similar to SIPA.

(D) *Futures commission merchant accounts.* Any futures, commodity, or similar account maintained with a futures commission merchant that is an audit client.

(E) *Credit cards.* Any aggregate outstanding credit card balance owed to a lender that is an audit client that is not reduced to $10,000 or less on a current basis taking into consideration the payment due date and any available grace period.

(F) *Insurance products.* Any individual policy issued by an insurer that is an audit client unless:

(*1*) The policy was obtained at a time when the covered person in the firm was not a covered person in the firm; and

(*2*) The likelihood of the insurer becoming insolvent is remote.

(G) *Investment companies.* Any financial interest in an entity that is part of an investment company complex that includes an audit client.

(iii) *Exceptions.* Notwithstanding paragraphs (c)(1)(i) and (c)(1)(ii) of this section, an accountant will not be deemed not independent if:

(A) *Inheritance and gift.* Any person acquires an unsolicited financial interest, such as through an unsolicited gift or inheritance, that would cause an accountant to be not independent under paragraph (c)(1)(i) or (c)(1)(ii) of this section, and the financial interest is disposed of as soon as practicable, but no later than 30 days after the person has knowledge of and the right to dispose of the financial interest.

(B) *New audit engagement.* Any person has a financial interest that would cause an accountant to be not independent under paragraph (c)(1)(i) or (c)(1)(ii) of this section, and:

(*1*) The accountant did not audit the client's financial statements for the immediately preceding fiscal year; and

(*2*) The accountant is independent under paragraph (c)(1)(i) and (c)(1)(ii) of this section before the earlier of:

(*i*) Signing an initial engagement letter or other agreement to provide audit, review, or attest services to the audit client; or

(*ii*) Commencing any audit, review, or attest procedures (including planning the audit of the client's financial statements).

(C) *Employee compensation and benefit plans.* An immediate family member of a person who is a covered person in the firm only by virtue of paragraphs (f)(11)(iii) or (f)(11)(iv) of this section has a financial interest that would cause an accountant to be not independent under paragraph (c)(1)(i) or (c)(1)(ii) of this section, and the acquisition of the financial interest was an unavoidable consequence of participation in his or her employer's employee compensation or benefits program, provided that the financial interest, other than unexercised employee stock options, is disposed of as soon as practicable, but no later than 30 days after the person has the right to dispose of the financial interest.

(iv) *Audit clients' financial relationships.* An accountant is not independent when:

(A) *Investments by the audit client in the accounting firm.* An audit client has, or has agreed to acquire, any direct investment in the accounting firm, such as stocks, bonds, notes, options, or other securities, or the audit client's officers or directors are record or beneficial owners of more than 5% of the equity securities of the accounting firm.

(B) *Underwriting.* An accounting firm engages an audit client to act as an underwriter, broker-dealer, market-maker, promoter, or analyst with respect to securities issued by the accounting firm.

(2) *Employment relationships.* An accountant is not independent if, at any point during the audit and professional engagement period, the accountant has an employment relationship with an audit client, such as:

(i) *Employment at audit client of accountant.* A current partner, principal, shareholder, or professional employee of the accounting firm is employed by the audit client or serves as a member of the board of directors or similar management or governing body of the audit client.

(ii) *Employment at audit client of certain relatives of accountant.* A close family member of a covered person in the firm is in an accounting role or financial reporting oversight role at an audit client, or was in such a role during any period covered by an audit for which the covered person in the firm is a covered person.

(iii) *Employment at audit client of former employee of accounting firm.* (A) A former partner, principal, shareholder, or professional employee of an accounting firm is in an accounting role or financial reporting oversight role at an audit client, unless the individual:

(*1*) Does not influence the accounting firm's operations or financial policies;

(*2*) Has no capital balances in the accounting firm; and

(*3*) Has no financial arrangement with the accounting firm other than one providing for regular payment of a fixed dollar amount (which is not dependent on the revenues, profits, or earnings of the accounting firm):

(*i*) Pursuant to a fully funded retirement plan, rabbi trust, or, in jurisdictions in which a rabbi trust does not exist, a similar vehicle; or

(*ii*) In the case of a former professional employee who was not a partner, principal, or shareholder of the accounting firm and who has been disassociated from the accounting firm for more than five years, that is immaterial to the former professional employee; and

(B) A former partner, principal, shareholder, or professional employee of an accounting firm is in a financial reporting oversight role at an issuer (as defined in section 10A(f) of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1(f)), except an issuer that is an investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a–8), unless the individual:

(*1*) Employed by the issuer was not a member of the audit engagement team of the issuer during the one year period preceding the date that audit procedures commenced for the fiscal period that included the date of initial employment of the audit engagement team member by the issuer;

(*2*) For purposes of paragraph (c)(2)(iii)(B)(*1*) of this section, the following individuals are not considered to be members of the audit engagement team:

(*i*) Persons, other than the lead partner and the concurring partner, who provided ten or fewer hours of audit, review, or attest services during the period covered by paragraph (c)(2)(iii)(B)(*1*) of this section;

(*ii*) Individuals employed by the issuer as a result of a business combination between an issuer that is an audit client and the employing entity, provided employment was not in contemplation of the business combination and the audit committee of the successor issuer is aware of the prior employment relationship; and

(*iii*) Individuals that are employed by the issuer due to an emergency or other unusual situation provided that the audit committee determines that the relationship is in the interest of investors;

(*3*) For purposes of paragraph (c)(2)(iii)(B)(*1*) of this section, audit procedures are deemed to have commenced for a fiscal period the day following the filing of the issuer's periodic annual report with the Commission covering the previous fiscal period; or

(C) A former partner, principal, shareholder, or professional employee of an accounting firm is in a financial reporting oversight role with respect to an investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a–8), if:

(*1*) The former partner, principal, shareholder, or professional employee of an accounting firm is employed in a financial reporting oversight role related to the operations and financial reporting of the registered investment company at an entity in the investment company complex, as defined in (f)(14) of this section, that includes the registered investment company; and

(*2*) The former partner, principal, shareholder, or professional employee of an accounting firm employed by the registered investment company or any entity in the investment company complex was a member of the audit engagement team of the registered investment company or any other registered investment company in the investment company complex during the one year period preceding the date that audit procedures commenced that included the date of initial employment of the audit engagement team member by the registered investment company or any entity in the investment company complex.

(*3*) For purposes of paragraph (c)(2)(iii)(C)(*2*) of this section, the following individuals are not considered to be members of the audit engagement team:

(*i*) Persons, other than the lead partner and concurring partner, who provided ten or fewer hours of audit, review or attest services during the period covered by paragraph (c)(2)(iii)(C)(*2*) of this section;

(*ii*) Individuals employed by the registered investment company or any entity in the investment company complex as a result of a business combination between a registered investment company or any entity in the investment company complex that is an audit client and the employing entity, provided employment was not in contemplation of the business combination and the audit committee of the registered investment company is aware of the prior employment relationship; and

(*iii*) Individuals that are employed by the registered investment company or any entity in the investment company complex due to an emergency or other unusual situation provided that the audit committee determines that the relationship is in the interest of investors.

(*4*) For purposes of paragraph (c)(2)(iii)(C)(*2*) of this section, audit procedures are deemed to have commenced the day following the filing of the registered investment company's periodic annual report with the Commission.

(iv) *Employment at accounting firm of former employee of audit client.* A former officer, director, or employee of an audit client becomes a partner, principal, shareholder, or professional employee of the accounting firm, unless the individual does not participate in, and is not in a position to influence, the audit of the financial statements of the audit client covering any period during which he or she was employed by or associated with that audit client.

(3) *Business relationships.* An accountant is not independent if, at any point during the audit and professional engagement period, the accounting firm or any covered person in the firm has any direct or material indirect business relationship with an audit client, or with persons associated with the audit client in a decision-making capacity, such as an audit client's officers, directors, or substantial stockholders. The relationships described in this paragraph do not include a relationship in which the accounting firm or covered person in the firm provides professional services to an audit client or is a consumer in the ordinary course of business.

(4) *Non-audit services.* An accountant is not independent if, at any point during the audit and professional engagement period, the accountant provides the following non-audit services to an audit client:

(i) *Bookkeeping or other services related to the accounting records or financial statements of the audit client.* Any service, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements, including:

(A) Maintaining or preparing the audit client's accounting records;

(B) Preparing the audit client's financial statements that are filed with the Commission or that form the basis of financial statements filed with the Commission; or

(C) Preparing or originating source data underlying the audit client's financial statements.

(ii) *Financial information systems design and implementation.* Any service, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements, including:

(A) Directly or indirectly operating, or supervising the operation of, the audit client's information system or managing the audit client's local area network; or

(B) Designing or implementing a hardware or software system that aggregates source data underlying the financial statements or generates information that is significant to the audit client's financial statements or other financial information systems taken as a whole.

(iii) *Appraisal or valuation services, fairness opinions, or contribution-in-kind reports.* Any appraisal service, valuation service, or any service involving a fairness opinion or contribution-in-kind report for an audit client, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements.

(iv) *Actuarial services.* Any actuarially-oriented advisory service involving the determination of amounts recorded in the financial statements and related accounts for the audit client other than assisting a client in understanding the methods, models, assumptions, and inputs used in computing an amount, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements.

(v) *Internal audit outsourcing services.* Any internal audit service that has been outsourced by the audit client that relates to the audit client's internal accounting controls, financial systems, or financial statements, for an audit client unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements.

(vi) *Management functions.* Acting, temporarily or permanently, as a director, officer, or employee of an audit client, or performing any decision-making, supervisory, or ongoing monitoring function for the audit client.

(vii) *Human resources.* (A) Searching for or seeking out prospective candidates for managerial, executive, or director positions;

(B) Engaging in psychological testing, or other formal testing or evaluation programs;

(C) Undertaking reference checks of prospective candidates for an executive or director position;

(D) Acting as a negotiator on the audit client's behalf, such as determining position, status or title, compensation, fringe benefits, or other conditions of employment; or

(E) Recommending, or advising the audit client to hire, a specific candidate for a specific job (except that an accounting firm may, upon request by the audit client, interview candidates and advise the audit client on the candidate's competence for financial accounting, administrative, or control positions).

(viii) *Broker-dealer, investment adviser, or investment banking services.* Acting as a broker-dealer (registered or unregistered), promoter, or underwriter, on behalf of an audit client, making investment decisions on behalf of the audit client or otherwise having discretionary authority over an audit client's investments, executing a transaction to buy or sell an audit client's investment, or having custody of assets of the audit client, such as taking temporary possession of securities purchased by the audit client.

(ix) *Legal services.* Providing any service to an audit client that, under circumstances in which the service is provided, could be provided only by someone licensed, admitted, or otherwise qualified to practice law in the jurisdiction in which the service is provided.

(x) *Expert services unrelated to the audit.* Providing an expert opinion or other expert service for an audit client, or an audit client's legal representative, for the purpose of advocating an audit client's interests in litigation or in a regulatory or administrative proceeding or investigation. In any litigation or regulatory or administrative proceeding or investigation, an accountant's independence shall not be deemed to be impaired if the accountant provides factual accounts, including in testimony, of work performed or explains the positions taken or conclusions reached during the performance of any service provided by the accountant for the audit client.

(5) *Contingent fees.* An accountant is not independent if, at any point during the audit and professional engagement period, the accountant provides any service or product to an audit client for a contingent fee or a commission, or receives a contingent fee or commission from an audit client.

(6) *Partner rotation.* (i) Except as provided in paragraph (c)(6)(ii) of this section, an accountant is not independent of an audit client when:

(A) Any audit partner as defined in paragraph (f)(7)(ii) of this section performs:

(*1*) The services of a lead partner, as defined in paragraph (f)(7)(ii)(A) of this section, or concurring partner, as defined in paragraph (f)(7)(ii)(B) of this section, for more than five consecutive years; or

(*2*) One or more of the services defined in paragraphs (f)(7)(ii)(C) and (D) of this section for more than seven consecutive years;

(B) Any audit partner:

(*1*) Within the five consecutive year period following the performance of services for the maximum period permitted under paragraph (c)(6)(i)(A)(*1*) of this section, performs for that audit client the services of a lead partner, as defined in paragraph (f)(7)(ii)(A) of this section, or concurring partner, as defined in paragraph (f)(7)(ii)(B) of this section, or a combination of those services, or

(*2*) Within the two consecutive year period following the performance of services for the maximum period permitted under paragraph (c)(6)(i)(A)(*2*) of this section, performs one or more of the services defined in paragraph (f)(7)(ii) of this section.

(ii) Any accounting firm with less than five audit clients that are issuers (as defined in section 10A(f) of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1(f))) and less than ten partners shall be exempt from paragraph (c)(6)(i) of this section *provided* the Public Company Accounting Oversight Board conducts a review at least once every three years of each of the audit client engagements that would result in a lack of auditor independence under this paragraph.

(iii) For purposes of paragraph (c)(6)(i) of this section, an audit client that is an investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a–8), does not include an affiliate of the audit client that is an entity in the same investment company complex, as defined in paragraph (f)(14) of this section, except for another registered investment company in the same investment company complex. For purposes of calculating consecutive years of service under paragraph (c)(6)(i) of this section with respect to investment companies in an investment company complex, audits of registered investment companies with different fiscal year-ends that are performed in a continuous 12-month period count as a single consecutive year.

(7) *Audit committee administration of the engagement.* An accountant is not independent of an issuer (as defined in section 10A(f) of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1(f))), other than an issuer that is an Asset-Backed Issuer as defined in § 229.1101 of this chapter, or an investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a–8), other than a unit investment trust as defined by section 4(2) of the Investment Company Act of 1940 (15 U.S.C. 80a–4(2)), unless:

(i) In accordance with Section 10A(i) of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1(i)) either:

(A) Before the accountant is engaged by the issuer or its subsidiaries, or the registered investment company or its subsidiaries, to render audit or non-audit services, the engagement is approved by the issuer's or registered investment company's audit committee; or

(B) The engagement to render the service is entered into pursuant to pre-approval policies and procedures established by the audit committee of the issuer or registered investment company, *provided* the policies and procedures are detailed as to the particular service and the audit committee is informed of each service and such policies and procedures do not include delegation of the audit committees responsibilities under the Securities Exchange Act of 1934 to management; or

(C) With respect to the provision of services other than audit, review or attest services the pre-approval requirement is waived if:

(*1*) The aggregate amount of all such services provided constitutes no more than five percent of the total amount of revenues paid by the audit client to its accountant during the fiscal year in which the services are provided;

(*2*) Such services were not recognized by the issuer or registered investment company at the time of the engagement to be non-audit services; and

(*3*) Such services are promptly brought to the attention of the audit committee of the issuer or registered investment company and approved prior to the completion of the audit by the audit committee or by one or more members of the audit committee who are members of the board of directors to whom authority to grant such approvals has been delegated by the audit committee.

(ii) A registered investment company's audit committee also must pre-approve its accountant's engagements for non-audit services with the registered investment company's investment adviser (not including a sub-adviser whose role is primarily portfolio management and is sub-contracted or overseen by another investment adviser) and any entity controlling, controlled by, or under common control with the investment adviser that provides ongoing services to the registered investment company in accordance with paragraph (c)(7)(i) of this section, if the engagement relates directly to the operations and financial reporting of the registered investment company, except that with respect to the waiver of the pre-approval requirement under paragraph (c)(7)(i)(C) of this section, the aggregate amount of all services provided constitutes no more than five percent of the total amount of revenues paid to the registered investment company's accountant by the registered investment company, its investment adviser and any entity controlling, controlled by, or under common control with the investment adviser that provides ongoing services to the registered investment company during the fiscal year in which the services are provided that would have to be pre-approved by the registered investment company's audit committee pursuant to this section.

(8) *Compensation.* An accountant is not independent of an audit client if, at any point during the audit and professional engagement period, any audit partner earns or receives compensation based on the audit partner procuring engagements with that audit client to provide any products or services other than audit, review or attest services. Any accounting firm with fewer than ten partners and fewer than five audit clients that are issuers (as defined in section 10A(f) of the Securities Exchange Act of 1934 (15 U.S.C. 78j–1(f))) shall be exempt from the requirement stated in the previous sentence.

(d) *Quality controls.* An accounting firm's independence will not be impaired solely because a covered person in the firm is not independent of an audit client provided:

(1) The covered person did not know of the circumstances giving rise to the lack of independence;

(2) The covered person's lack of independence was corrected as promptly as possible under the relevant circumstances after the covered person or accounting firm became aware of it; and

(3) The accounting firm has a quality control system in place that provides reasonable assurance, taking into account the size and nature of the accounting firm's practice, that the accounting firm and its employees do not lack independence, and that covers at least all employees and associated entities of the accounting firm participating in the engagement, including employees and associated entities located outside of the United States.

(4) For an accounting firm that annually provides audit, review, or attest services to more than 500 companies with a class of securities registered with the Commission under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78*l*), a quality control system will not provide such reasonable assurance unless it has at least the following features:

(i) Written independence policies and procedures;

(ii) With respect to partners and managerial employees, an automated system to identify their investments in securities that might impair the accountant's independence;

(iii) With respect to all professionals, a system that provides timely information about entities from which the accountant is required to maintain independence;

(iv) An annual or on-going firm-wide training program about auditor independence;

(v) An annual internal inspection and testing program to monitor adherence to independence requirements;

(vi) Notification to all accounting firm members, officers, directors, and employees of the name and title of the member of senior management responsible for compliance with auditor independence requirements;

(vii) Written policies and procedures requiring all partners and covered persons to report promptly to the accounting firm when they are engaged in employment negotiations with an audit client, and requiring the firm to remove immediately any such professional from that audit client's engagement and to review promptly all work the professional performed related to that audit client's engagement; and

(viii) A disciplinary mechanism to ensure compliance with this section.

(e)(1) *Transition and grandfathering.* Provided the following relationships did not impair the accountant's independence under pre-existing requirements of the Commission, the Independence Standards, Board, or the accounting profession in the United States, the existence of the relationship on May 6, 2003 will not be deemed to impair an accountant's independence:

(i) Employment relationships that commenced at the issuer prior to May 6, 2003 as described in paragraph (c)(2)(iii)(B) of this section.

(ii) Compensation earned or received, as described in paragraph (c)(8) of this section during the fiscal year of the accounting firm that includes the effective date of this section.

(iii) Until May 6, 2004, the provision of services described in paragraph (c)(4) of this section provided those services are pursuant to contracts in existence on May 6, 2003.

(iv) The provision of services by the accountant under contracts in existence on May 6, 2003 that have not been pre-approved by the audit committee as described in paragraph (c)(7) of this section.

(v) Until the first day of the issuer's fiscal year beginning after May 6, 2003 by a ''lead'' partner and other audit partner (other than the ''concurring'' partner) providing services in excess of those permitted under paragraph (c)(6) of this section. An accountant's independence will not be deemed to be impaired until the first day of the issuer's fiscal year beginning after May 6, 2004 by a ''concurring'' partner providing services in excess of those permitted under paragraph (c)(6) of this section. For the purposes of calculating periods of service under paragraph (c)(6) of this section:

(A) For the ''lead'' and ''concurring'' partner, the period of service includes time served as the ''lead'' or ''concurring'' partner prior to May 6, 2003; and

(B) For audit partners other than the ''lead'' partner or ''concurring'' partner, and for audit partners in foreign firms, the period of service does not include time served on the audit engagement team prior to the first day of issuer's fiscal year beginning on or after May 6, 2003.

(2) *Settling financial arrangements with former professionals.* To the extent not required by pre-existing requirements of the Commission, the Independence Standards Board, or the accounting profession in the United States, the requirement in paragraph (c)(2)(iii) of this section to settle financial arrangements with former professionals applies to situations that arise after the effective date of this section.

(f) *Definitions of terms.* For purposes of this section:

(1) *Accountant,* as used in paragraphs (b) through (e) of this section, means a registered public accounting firm, certified public accountant or public accountant performing services in connection with an engagement for which independence is required. References to the accountant include any accounting firm with which the certified public accountant or public accountant is affiliated.

(2) *Accounting firm* means an organization (whether it is a sole proprietorship, incorporated association, partnership, corporation, limited liability company, limited liability partnership, or other legal entity) that is engaged in the practice of public accounting and furnishes reports or other documents filed with the Commission or otherwise prepared under the securities laws, and all of the organization's departments, divisions, parents, subsidiaries, and associated entities, including those located outside of the United States. Accounting firm also includes the organization's pension, retirement, investment, or similar plans.

(3)(i) *Accounting role* means a role in which a person is in a position to or does exercise more than minimal influence over the contents of the accounting records or anyone who prepares them.

(ii) *Financial reporting oversight role* means a role in which a person is in a position to or does exercise influence over the contents of the financial statements or anyone who prepares them, such as when the person is a member of the board of directors or similar management or governing body, chief executive officer, president, chief financial officer, chief operating officer, general counsel, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer, or any equivalent position.

(4) *Affiliate of the audit client* means:

(i) An entity that has control over the audit client, or over which the audit client has control, or which is under common control with the audit client, including the audit client's parents and subsidiaries;

(ii) An entity over which the audit client has significant influence, unless the entity is not material to the audit client;

(iii) An entity that has significant influence over the audit client, unless the audit client is not material to the entity; and

(iv) Each entity in the investment company complex when the audit client is an entity that is part of an investment company complex.

(5) *Audit and professional engagement period* includes both:

(i) The period covered by any financial statements being audited or reviewed (the ''audit period''); and

(ii) The period of the engagement to audit or review the audit client's financial statements or to prepare a report filed with the Commission (the ''professional engagement period''):

(A) The professional engagement period begins when the accountant either signs an initial engagement letter (or other agreement to review or audit a client's financial statements) or begins audit, review, or attest procedures, whichever is earlier; and

(B) The professional engagement period ends when the audit client or the accountant notifies the Commission that the client is no longer that accountant's audit client.

(iii) For audits of the financial statements of foreign private issuers, the ''audit and professional engagement period'' does not include periods ended prior to the first day of the last fiscal year before the foreign private issuer first filed, or was required to file, a registration statement or report with the Commission, provided there has been full compliance with home country independence standards in all prior periods covered by any registration statement or report filed with the Commission.

(6) *Audit client* means the entity whose financial statements or other information is being audited, reviewed, or attested and any affiliates of the audit client, other than, for purposes of paragraph (c)(1)(i) of this section, entities that are affiliates of the audit client only by virtue of paragraph (f)(4)(ii) or (f)(4)(iii) of this section.

(7)(i) *Audit engagement team* means all partners, principals, shareholders and professional employees participating in an audit, review, or attestation engagement of an audit client, including audit partners and all persons who consult with others on the audit engagement team during the audit, review, or attestation engagement regarding technical or industry-specific issues, transactions, or events.

(ii) *Audit partner* means a partner or persons in an equivalent position, other than a partner who consults with others on the audit engagement team during the audit, review, or attestation engagement regarding technical or industry-specific issues, transactions, or events, who is a member of the audit engagement team who has responsibility for decision-making on significant auditing, accounting, and reporting matters that affect the financial statements, or who maintains regular contact with management and the audit committee and includes the following:

(A) The lead or coordinating audit partner having primary responsibility for the audit or review (the ''lead partner'');

(B) The partner performing a second level of review to provide additional assurance that the financial statements subject to the audit or review are in conformity with generally accepted accounting principles and the audit or review and any associated report are in accordance with generally accepted auditing standards and rules promulgated by the Commission or the Public Company Accounting Oversight Board (the ''concurring or reviewing partner'');

(C) Other audit engagement team partners who provide more than ten hours of audit, review, or attest services in connection with the annual or interim consolidated financial statements of the issuer or an investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a–8); and

(D) Other audit engagement team partners who serve as the ''lead partner'' in connection with any audit or review related to the annual or interim financial statements of a subsidiary of the issuer whose assets or revenues constitute 20% or more of the assets or revenues of the issuer's respective consolidated assets or revenues.

(8) *Chain of command* means all persons who:

(i) Supervise or have direct management responsibility for the audit, including at all successively senior levels through the accounting firm's chief executive;

(ii) Evaluate the performance or recommend the compensation of the audit engagement partner; or

(iii) Provide quality control or other oversight of the audit.

(9) *Close family members* means a person's spouse, spousal equivalent, parent, dependent, nondependent child, and sibling.

(10) *Contingent fee* means, except as stated in the next sentence, any fee established for the sale of a product or the performance of any service pursuant to an arrangement in which no fee will be charged unless a specified finding or result is attained, or in which the amount of the fee is otherwise dependent upon the finding or result of such product or service. Solely for the purposes of this section, a fee is not a ''contingent fee'' if it is fixed by courts or other public authorities, or, in tax matters, if determined based on the results of judicial proceedings or the findings of governmental agencies. Fees may vary depending, for example, on the complexity of services rendered.

(11) *Covered persons in the firm* means the following partners, principals, shareholders, and employees of an accounting firm:

(i) The ''audit engagement team'';

(ii) The ''chain of command'';

(iii) Any other partner, principal, shareholder, or managerial employee of the accounting firm who has provided ten or more hours of non-audit services to the audit client for the period beginning on the date such services are provided and ending on the date the accounting firm signs the report on the financial statements for the fiscal year during which those services are provided, or who expects to provide ten or more hours of non-audit services to the audit client on a recurring basis; and

(iv) Any other partner, principal, or shareholder from an ''office'' of the accounting firm in which the lead audit engagement partner primarily practices in connection with the audit.

(12) *Group* means two or more persons who act together for the purposes of acquiring, holding, voting, or disposing of securities of a registrant.

(13) *Immediate family members* means a person's spouse, spousal equivalent, and dependents.

(14) *Investment company complex.* (i) ''Investment company complex'' includes:

(A) An investment company and its investment adviser or sponsor;

(B) Any entity controlled by or controlling an investment adviser or sponsor in paragraph (f)(14)(i)(A) of this section, or any entity under common control with an investment adviser or sponsor in paragraph (f)(14)(i)(A) of this section if the entity:

(*1*) Is an investment adviser or sponsor; or

(*2*) Is engaged in the business of providing administrative, custodian, underwriting, or transfer agent services to any investment company, investment adviser, or sponsor; and

(C) Any investment company or entity that would be an investment company but for the exclusions provided by section 3(c) of the Investment Company Act of 1940 (15 U.S.C. 80a–3(c)) that has an investment adviser or sponsor included in this definition by either paragraph (f)(14)(i)(A) or (f)(14)(i)(B) of this section.

(ii) An investment adviser, for purposes of this definition, does not include a sub-adviser whose role is primarily portfolio management and is subcontracted with or overseen by another investment adviser.

(iii) Sponsor, for purposes of this definition, is an entity that establishes a unit investment trust.

(15) *Office* means a distinct sub-group within an accounting firm, whether distinguished along geographic or practice lines.

(16) *Rabbi trust* means an irrevocable trust whose assets are not accessible to the accounting firm until all benefit obligations have been met, but are subject to the claims of creditors in bankruptcy or insolvency.

(17) *Audit committee* means a committee (or equivalent body) as defined

in section 3(a)(58) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(58)).

[37 FR 14594, July 21, 1972, as amended at 48 FR 9521, Mar. 7, 1983; 65 FR 76082, Dec. 5, 2000; 68 FR 6044, Feb. 5, 2003; 70 FR 1593, Jan. 7, 2005]

§ 210.2–02 Accountants' reports and attestation reports.

(a) *Technical requirements for accountants' reports.* The accountant's report:

(1) Shall be dated;

(2) Shall be signed manually;

(3) Shall indicate the city and State where issued; and

(4) Shall identify without detailed enumeration the financial statements covered by the report.

(b) *Representations as to the audit included in accountants' reports.* The accountant's report:

(1) Shall state whether the audit was made in accordance with generally accepted auditing standards; and

(2) Shall designate any auditing procedures deemed necessary by the accountant under the circumstances of the particular case, which have been omitted, and the reasons for their omission. Nothing in this rule shall be construed to imply authority for the omission of any procedure which independent accountants would ordinarily employ in the course of an audit made for the purpose of expressing the opinions required by paragraph (c) of this section.

(c) *Opinions to be expressed in accountants' reports.* The accountant's report shall state clearly:

(1) The opinion of the accountant in respect of the financial statements covered by the report and the accounting principles and practices reflected therein; and

(2) the opinion of the accountant as to the consistency of the application of the accounting principles, or as to any changes in such principles which have a material effect on the financial statements.

(d) *Exceptions identified in accountants' reports.* Any matters to which the accountant takes exception shall be clearly identified, the exception thereto specifically and clearly stated, and, to the extent practicable, the effect of each such exception on the related financial statements given. (See section 101 of the Codification of Financial Reporting Policies.)

(e) Paragraph (e) of this section applies only to registrants that are providing financial statements in a filing for a period with respect to which Arthur Andersen LLP or a foreign affiliate of Arthur Andersen LLP (''Andersen'') issued an accountants' report. Notwithstanding any other Commission rule or regulation, a registrant that cannot obtain an accountants' report that meets the technical requirements of paragraph (a) of this section after reasonable efforts may include in the document a copy of the latest signed and dated accountants' report issued by Andersen for such period in satisfaction of that requirement, if prominent disclosure that the report is a copy of the previously issued Andersen accountants' report and that the report has not been reissued by Andersen is set forth on such copy.

(f) *Attestation report on internal control over financial reporting.* (1) Every registered public accounting firm that issues or prepares an accountant's report for a registrant, other than a registrant that is neither an accelerated filer nor a large accelerated filer (as defined in § 240.12b–2 of this chapter) or an investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a–8), that is included in an annual report required by section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*) containing an assessment by management of the effectiveness of the registrant's internal control over financial reporting must include an attestation report on internal control over financial reporting.

(2) If an attestation report on internal control over financial reporting is included in an annual report required by section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*), it shall clearly state the opinion of the accountant, either unqualified or adverse, as to whether the registrant maintained, in all material respects, effective internal control over financial reporting, except in the rare circumstance of a scope limitation that cannot be overcome by the registrant or the registered public accounting firm which would result in

(3) Submission of the report (or documentation) by the independent accountant as described in paragraphs (b)(1) and (b)(2) of this section shall not replace, or otherwise satisfy the need for, the newly engaged and former accountants' letters under Items 304(a)(2)(D) and 304(a)(3) of Regulation S–K, §§ 229.304(a)(2)(D) and 229.304(a)(3) of this chapter, respectively, and shall not limit, reduce, or affect in any way the independent accountant's obligations to comply fully with all other legal and professional responsibilities, including, without limitation, those under generally accepted auditing standards and the rules or interpretations of the Commission that modify or supplement those auditing standards.

(c) A notice or report submitted to the Office of the Chief Accountant in accordance with paragraphs (a) and (b) of this section shall be deemed to be an investigative record and shall be nonpublic and exempt from disclosure pursuant to the Freedom of Information Act to the same extent and for the same periods of time that the Commission's investigative records are nonpublic and exempt from disclosure under, among other applicable provisions, 5 U.S.C. 552(b)(7) and § 200.80(b)(7) of this chapter. Nothing in this paragraph, however, shall relieve, limit, delay, or affect in any way, the obligation of any issuer or any independent accountant to make all public disclosures required by law, by any Commission disclosure item, rule, report, or form, or by any applicable accounting, auditing, or professional standard.

INSTRUCTION TO PARAGRAPH (c): Issuers and independent accountants may apply for additional bases for confidential treatment for a notice, report, or part thereof, in accordance with § 200.83 of this chapter. That section indicates, in part, that any person who, pursuant to any requirement of law, submits any information or causes or permits any information to be submitted to the Commission, may request that the Commission afford it confidential treatment by reason of personal privacy or business confidentiality, or for any other reason permitted by Federal law.

[62 FR 12749, Mar. 18, 1997, as amended at 73 FR 973, Jan. 4, 2008]

§ 240.10A–2 Auditor independence.

It shall be unlawful for an auditor not to be independent under § 210.2–01(c)(2)(iii)(B), (c)(4), (c)(6), (c)(7), and § 210.2–07.

[68 FR 6048, Feb. 5, 2003]

§ 240.10A–3 Listing standards relating to audit committees.

(a) Pursuant to section 10A(m) of the Act (15 U.S.C. 78j–1(m)) and section 3 of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7202):

(1) *National securities exchanges.* The rules of each national securities exchange registered pursuant to section 6 of the Act (15 U.S.C. 78f) must, in accordance with the provisions of this section, prohibit the initial or continued listing of any security of an issuer that is not in compliance with the requirements of any portion of paragraph (b) or (c) of this section.

(2) *National securities associations.* The rules of each national securities association registered pursuant to section 15A of the Act (15 U.S.C. 78o–3) must, in accordance with the provisions of this section, prohibit the initial or continued listing in an automated inter-dealer quotation system of any security of an issuer that is not in compliance with the requirements of any portion of paragraph (b) or (c) of this section.

(3) *Opportunity to cure defects.* The rules required by paragraphs (a)(1) and (a)(2) of this section must provide for appropriate procedures for a listed issuer to have an opportunity to cure any defects that would be the basis for a prohibition under paragraph (a) of this section, before the imposition of such prohibition. Such rules also may provide that if a member of an audit committee ceases to be independent in accordance with the requirements of this section for reasons outside the member's reasonable control, that person, with notice by the issuer to the applicable national securities exchange or national securities association, may remain an audit committee member of the listed issuer until the earlier of the next annual shareholders meeting of the listed issuer or one year from the occurrence of the event that caused the member to be no longer independent.

(4) *Notification of noncompliance.* The rules required by paragraphs (a)(1) and (a)(2) of this section must include a requirement that a listed issuer must notify the applicable national securities

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Lacy WRIGHT, Jr. et al., Plaintiffs,
v.
James M. SUTTON, et al., Defendants.

Civil Action No. 1:08–1431. | March 29, 2011.

Attorneys and Law Firms

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MEMORANDUM OPINION AND ORDER

DAVID A. FABER, Senior District Judge.

***1** Pending before the court is a motion by Crowe Chizek and Company, LLC (hereinafter "Crowe") to dismiss the Amended Complaint. (Doc. # 55). [1] For reasons expressed more fully below, that motion is GRANTED.

I. Background

On October 27, 2006, plaintiffs filed this civil action, in the Circuit Court of McDowell County, against various defendants, including Crowe, alleging that defendants engaged in a "freeze-out" of plaintiff Lacy Wright and other John Doe minority shareholders in Ameribank, committed fraud, engaged in civil conspiracy, and were negligent. *See* Complaint generally. On September 19, 2008, the Office of Thrift Supervision closed Ameribank and appointed the Federal Deposit Insurance Corporation ("FDIC") as Receiver.

On December 17, 2008, the FDIC filed a Motion to Substitute, in the McDowell County Circuit Court, seeking to substitute the FDIC as Receiver for defendant Ameribank. On that same day, the FDIC removed the case to federal court. On September 29, 2010, the court granted the motion to dismiss filed by the FDIC as Receiver for Ameribank for lack of subject matter jurisdiction based on plaintiffs' failure to exhaust administrative remedies.

On July 6, 2010, the court granted Crowe's motion for a more definite statement. In particular, plaintiffs were directed to explain:

> 1) the nature of each claim for relief they are asserting while providing separate counts for each individual claim, 2) any statute or regulation allegedly violated (if applicable), 3) the facts that support each claim, and 4) the relief he seeks for each claim. The amended complaint must also specifically identify which counts are applicable to which defendants. Furthermore, plaintiffs are reminded of Federal Rule of Civil Procedure 12(f) and directed to omit from their more definite statement any impertinent or scandalous matter such as that contained the last sentences of paragraphs numbered 20 and 21 of the original complaint.

Order of July 6, 2010 at pp. 3–4. Plaintiffs were also warned that failure to comply with the court's Order might result in dismissal of this action without prejudice.

On July 20, 2010, plaintiffs filed a ten-count Amended Complaint. According to the Amended Complaint, Crowe was retained by "American Bankshares, Inc. to provide accounting, auditing, business and consulting services to Ameribank." Amended Complaint ¶ 13. In response to the court's directive that plaintiffs identify the specific defendant against whom each claim was asserted, plaintiffs have alleged that all claims in the Amended Complaint are alleged against Crowe. The allegations specific to Crowe are as follows:

> 20. That based upon information and belief, the Defendant Crowe Chizek and Company, LLC negligently and carelessly failed to conduct audits in accordance with applicable professional standards breaching a duty to Plaintiff and others proximately causing the Plaintiff and others to sustain harm, injuries and damages and also which resulted in the insolvency and subsequent closure of Defendant, Ameribank, Inc. by the FDIC.
>
> ***2** 21. That based upon information and belief the Defendant, Crowe Chizek and Company, LLC negligently prepared audit reports or carelessly performed audits, other audit functions and other banking and business documents resulting in false and misleading communications being sent or communicated to the Plaintiff and others proximately causing the Plaintiff and others to sustain harm, injuries, and damages.
>
> 33. That the Defendant, "Crowe" and/or other Defendants as aforesaid fraudulently and/or negligently failed to properly and accurately disclose the true financial condition of Defendant American Bankshares, Inc. and Ameribank, Inc.; failed to disclose material information; and assisted in the publication and dissemination of false and misleading information, thereby conspiring and colluding with the other Defendants and breaching a fiduciary duty to the Plaintiff and others.
>
> 63. That based upon information and belief the Defendant, Crowe Chizek and Company, LLC and other Defendants as aforesaid caused audit reports, financial reports and other documents to be communicated to the Plaintiff and others that were misleading because the audits and preparation of other banking related documents were negligently performed proximately causing the Plaintiff and others to sustain harm, injuries and damages.

Amended Complaint ¶¶ 20, 21, 33, and 63.

Crowe has moved to dismiss the Amended Complaint as to it on a number of different grounds.

II. Standard of Review

"[A] motion to dismiss for failure to state a claim for relief should not be granted unless it appears to a certainty that the plaintiff would be entitled to no relief under any state of facts which could be proved in support of his claim." *Rogers v. Jefferson–Pilot Life Ins. Co.,* 883 F.2d 324, 325 (4th Cir.1989) (citation omitted) (quoting *Conley v. Gibson,* 355 U.S. 41, 48 (1957), and *Johnson v. Mueller,* 415 F.2d 354, 355 (4th Cir.1969)). "In considering a motion to dismiss, the court should accept as true all well-pleaded allegations and should view the complaint in a light most favorable to the plaintiff." *Mylan Laboratories, Inc. v. Matkari,* 7 F.3d 1130, 1134 (4th Cir.1993); *see also Ibarra v. United States,* 120 F.3d 474, 474 (4th Cir.1997).

In evaluating the sufficiency of a pleading, the recent cases of *Bell Atl. Corp. v. Twombly,* 127 S.Ct. 1955 (2007), and *Ashcroft v. Iqbal,* 129 S.Ct. 1937 (2009), provide guidance. When reviewing a motion to dismiss, under Federal Rule of Civil Procedure 12(b)(6), for failure to state a claim upon which relief may be granted, a court must determine whether the factual allegations contained in the complaint "give the defendant fair notice of what the ... claim is and the grounds upon which it rests," and, when accepted as true, "raise a right to relief above the speculative level." *Bell Atl. Corp. v. Twombly,* 127 S.Ct. 1955, 1964–65 (2007)(*quoting Conley v. Gibson,* 355 U.S. 41, 47 (1957); 5 Charles Alan Wright & Arthur R. Miller, *Federal Practice and Procedure* § 1216 (3d ed.2004)). "[O]nce a claim has been stated adequately, it may be supported by showing any set of facts consistent with the allegations in the complaint." *Twombly,* 127 S.Ct. at 1969. As the Fourth Circuit has explained, "[a] complaint attacked by a Rule 12(b)(6) motion to dismiss will survive if it contains 'enough facts to state a claim to relief that is plausible on its face.' " *Lainer v. Norfolk S. Corp.,* 2007 WL 4270847 at *3 (4th Cir.2007) (*quoting Twombly,* 127 S.Ct. at 1974).

***3** According to *Iqbal* and the interpretation given it by our appeals court,

> [L]egal conclusions, elements of a cause of action, and bare assertions devoid of further factual enhancement fail to constitute well-pled facts for Rule 12(b)(6) purposes. *See Iqbal,* 129 S.Ct. at 1949. We also decline to consider "unwarranted inferences, unreasonable conclusions, or arguments." *Wahi v. Charleston Area Med. Ctr., Inc.,* 562 F.3d 599, 615 n. 26 (4th Cir.2009); *see also Iqbal,* 129 S.Ct. at 1951–52.
>
> Ultimately, a complaint must contain "sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.' " *Iqbal,* 129 S.Ct. at 1949 (quoting *Bell Atl. Corp. v. Twombly,* 550 U.S. 544, 570, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007)). Facial plausibility is established once the factual content of a complaint "allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Id.* In other words, the complaint's factual allegations must produce an inference of liability strong enough to nudge the plaintiff's claims " 'across the line from conceivable to plausible.' " *Id.* at 1952 (quoting *Twombly,* 550 U.S. at 570, 127 S.Ct.1955).
>
> Satisfying this "context-specific" test does not require "detailed factual allegations." *Id.* at 1949–50 (quotations omitted). The complaint must, however, plead sufficient facts to allow a court, drawing on "judicial experience and common sense," to infer "more than the mere possibility of misconduct." *Id.* at 1950. Without such "heft," *id.* at 1947, the plaintiff's claims cannot establish a valid entitlement to relief, as facts that are "merely consistent with a defendant's liability," *id.* at 1949, fail to nudge claims "across the line from conceivable to plausible." *Id.* at 1951 (quotations omitted).

Nemet Chevrolet, LTD v. Consumeraffairs.com, Inc., 591 F.3d 250, 255–56 (4th Cir.2009).

III. Analysis

A. Counts 1 and 4: Negligence and Negligent Misrepresentation

Counts 1 and 4 appear to state professional negligence claims against Crowe based on the work it did for Ameribank. Plaintiffs also allege, for the first time, that Crowe's negligence led to the bank's closure. Crowe argues that the court should dismiss the professional negligence claims to the extent that they allege new facts, legal theories, and causes of action.

Even were the court inclined to construe plaintiffs' first amended complaint as seeking leave to assert these additional matters, it would be compelled to deny such a motion to amend. Viewing the Amended Complaint through the lens of *Twombly* and *Iqbal,* the court finds that the pleading falls far short of what is required to withstand dismissal.

In order to recover on a claim of professional malpractice, the plaintiffs must show: (1) the existence of a legal duty owed by the defendant to the plaintiff, (2) a breach of that duty, and (3) damages proximately caused by the breach. *See Sewell v. Gregory,* 179 W. Va. 585, 371 S.E.2d 82, 84 (1988). In the case of a client suing a retained professional for negligence, the existence of a duty is established by virtue of the client hiring the professional. *See Calvert v. Scharf,* 217 W. Va. 684, 619 S.E.2d 197, 203 (2005); *McGuire v. Fitzsimmons,* 197 W. Va. 132, 475 S.E .2d 132, 136–37 (1996).

***4** Under West Virginia law, as interpreted by the United States Court of Appeals for the Fourth Circuit, in order to establish liability against an accountant for the accountant's negligent misrepresentations, an injured party is required to prove (1) inaccurate information, (2) negligently supplied, (3) in the course of an accountant's professional endeavors, (4) to a third person or limited group of third persons for whose benefit and guidance the accountant actually intends or knows will receive the information, (5) for a transaction, or for a substantially similar transaction that the accountant actually intends to influence or knows that the recipient so intends, (6) with the result that the third party justifiably relies on such misinformation to his detriment. *Ellis v. Grant Thornton LLP,* 530 F.3d 280, 289 (4th Cir.2008).

Plaintiffs do not offer factual or legal support for either claim. As to Count 1, the professional negligence claim, plaintiffs fail to plead sufficient facts for this court to determine that they can satisfy any of the three elements. For example, they merely state, in conclusory fashion, that they suffered damages but they do not offer sufficient factual detail for this court to determine they have a viable claim. The negligent misrepresentation claim suffers from the same infirmities. "[N]aked assertions devoid of further factual enhancement" are not sufficient to survive a motion to dismiss." *Ashcroft v. Iqbal,* 129 S.Ct. 1937, 1949 (2009). Accordingly, Counts 1 and 4 will be dismissed.

B. Count 2: Breach of Fiduciary Duty

Plaintiffs allege that all defendants, including Crowe, breached their fiduciary duty to plaintiffs. "The fiduciary duty is a duty to act for someone else's benefit, while subordinating one's personal interests to that of the other person. It is the highest standard of duty implied by law." *Elmore v. State Farm Mutual Automobile Ins. Co.,* 504 S.E.2d 893, 898 (W.Va.1998) (internal citations and quotations omitted). West Virginia's highest court further elaborated:

> Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions .... Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd[.]

Id. at 898–99 (quoting *Kanawha Valley Bank v. Friend,* 253 S.E.2d 528, 530 n. 2 (1979)).

In general, "an accountant hired to audit the financial statements of a client is not a fiduciary of the client, but rather is required to be independent of the client." *Strategic Capital Resources, Inc. v. Citrin Cooperman & Co., LLP,* 2007 WL 30836, *1 (11th Cir.2007) (quoting *TSG Water Resources, Inc. v. D'Alba & Donovan Certified Public Accountants, P.C.,* 366 F.Supp.2d 1212, 1227 (S.D.Ga.2004)); *see also Resolution Trust Corp. v. KPMG Peat Marwick,* 844 F.Supp. 431, 436 (N.D.Ill.1994) (holding independent auditor not in fiduciary relationship with client); *FDIC v. Schoenberger,* 781 F.Supp. 1155, 1157 (E.D.La.1992) (finding accountants do not owe fiduciary duty to clients when providing services as auditors); *Franklin Supply Co. v. Tolman,* 454 F.2d 1059, 1065 (9th Cir.1971) (holding accounting firm not in fiduciary relationship with client); *Micro Enhancement Int'l. Inc. v. Coopers & Lybrand, LLP,* 40 P.3d 1206, 1218 (Wash.2002) (holding absent special circumstances, auditor is not fiduciary of client).

***5** Crowe contends that it is an independent accountant and, as such, owed no fiduciary duty to plaintiffs. Although plaintiffs have not explained the basis of their assertion that Crowe was a fiduciary of plaintiffs, they do allege that Crowe was retained by "American Bankshares, Inc. to provide accounting, auditing, *business and consulting services* to Ameribank." Amended Complaint ¶ 13 (emphasis added). However, the specific conduct alleged against Crowe discusses only auditing and financial reporting. Amended Complaint ¶¶ 20, 21, 33, and 63. The Amended Complaint alleges nothing about Crowe's engagement that would except it from the general rule that an independent accountant does not have a fiduciary relationship with its client. Based on the foregoing, the motion to dismiss the breach of fiduciary duty claim will be granted.

C. Count 3: Oppressive Conduct

Count III of the Amended Complaint alleges oppressive conduct on the part of Crowe and other defendants. The alleged oppression relates to and arises out of the reverse stock split approved at the Board of Directors' meeting held on September 22, 2006. Amended Complaint pp. 15–21. According to plaintiff, Crowe and the other defendants "have engaged in a long and continuous course of conduct that was oppressive and involved a continuing series of wrongful acts by which the controlling Defendants attempted to oust the minority shareholders." Amended Complaint ¶ 46.

Under West Virginia law, "the majority stockholders in a corporation owe a fiduciary duty to the minority, as do the officers and directors...." *Masinter v. Webco Co.,* 262 S.E.2d 433, 438 (W.Va.1980). West Virginia also recognizes an "oppressive conduct exception to the general rule that a corporation has complete control of its affairs." *State ex rel. Smith v. Evans,* 547 S.E.2d 278, 283 (W.Va.2001). According to the West Virginia Supreme Court of Appeals, "[a] claim of a freeze-out rests on the wrongful denial by the majority shareholders of the legitimate claims or expectations of a minority shareholder." *Masinter,* 262 S.E.2d at 442.

The Amended Complaint does not allege that Crowe is a shareholder in, or a director of Ameribank. Furthermore, the Amended Complaint does not allege any conduct specific to Crowe to support its allegations of oppressive conduct. Given the foregoing, the court finds that plaintiff has failed to state a claim of oppression against Crowe.

D. Count 5: Intentional Misrepresentation

As to the intentional misrepresentation claim, plaintiff allege that Crowe

> engaged in a pattern of intentional misrepresentation and through oppression and deceit, ... misrepresented material facts concerning the true financial condition of the American Bankshares, Inc., and that said misrepresentations were made with scienter with a purposeful intent to induce the Plaintiff and others to act on said intentional misrepresentation or to purposefully induce the Plaintiff to refrain from acting because of the misrepresentation made by Defendants and that as a direct and proximate result of the Defendants' intentional misrepresentations made through fraud, oppression and deceit the Plaintiff justifiably relied on the misrepresentations ... provided to the press about the true financial condition of Ameribank, Inc./American Bankshares, Inc., and as a result of the intentional misrepresentations made by the Defendants the Plaintiff and others have sustained financial loss, harm and damages.

***6** Amended Complaint ¶ 70. Plaintiffs' intentional misrepresentation claim is essentially a claim for fraud. *See Fifth Third Bank v. McClure Properties, Inc.,* 724 F.Supp.2d 598, 610 (S.D.W.Va.2010) ("Fraud includes intentional misrepresentation and the elements required to prove each tort overlap."); *Gerver v.. Benavides,* 530 S.E.2d 701, 705 (W.Va.1999) ("Actual fraud is intentional, and consists of an intentional deception or misrepresentation to 'induce another to part with property or to surrender some legal right, and which accomplishes the end designed.' ").

Federal Rule of Civil Procedure 9(b) requires that "[i]n all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity." Plaintiffs' intentional misrepresentation claim is governed by Rule 9(b). *See Felman Production, Inc. V. Bannai,* 2007 WL 3244638, *7 (S.D.W.Va.2007). The Fourth Circuit has concluded that "a complaint which fails to specifically allege the time, place and nature of the fraud is subject to dismissal on a Rule 12(b)(6) motion." *Lasercomb America, Inc. v. Reynolds,* 911 F.2d 970, 980 (4th Cir.1990); *see also Holland v. Cline Brothers Mining Co.,* 877 F.Supp. 308, 318 (S.D.W.Va.1995).

Plaintiffs' intentional misrepresentation claim is not pled with the particularity required by Rule 9(b). The claim is stated wholly in conclusory form and fails to put defendant on notice of the time, place, or nature of the alleged fraud. For this reason, the intentional misrepresentation claim will be dismissed.

D. Count 6: Civil Conspiracy

Count 6 alleges that Crowe and the other defendants were engaged in a civil conspiracy to freeze-out the minority shareholders.

> A civil conspiracy is a combination of two or more persons by concerted action to accomplish an unlawful purpose or to accomplish some purpose, not in itself unlawful, by unlawful means. The cause of action is not created by the conspiracy but by the wrongful acts done by the defendants to the injury of the plaintiff.
>
> A civil conspiracy is not a per se, stand-alone cause of action; it is instead a legal doctrine under which liability for a tort may be imposed on people who did not actually commit a tort themselves but who shared a common plan for its commission with the actual perpetrator(s).

O'Dell v. Stegall, 703 S.E.2d 561, 595 (W.Va.2010). Plaintiffs have failed to plead sufficient facts for this court to conclude that it is plausible Crowe was engaged in a civil conspiracy to oppress plaintiffs. Accordingly, the claim will be dismissed.

E. Count 7: Bad Faith and Fair Dealing

Count VII is a claim for bad faith and fair dealing. "[T]he standards of good faith and fair dealing [ ] are inherent in the concept of a fiduciary relationship." *State ex rel. Smith v. Evans,* at 283. As noted above, plaintiffs have not alleged sufficient facts to show it is plausible there was a fiduciary relationship between plaintiffs and Crowe. Accordingly, the motion to dismiss Count VII as to Crowe will be granted.

F. Counts 8 and 10: Intentional Infliction of Emotional Distress and Outrage

***7** In order for a plaintiff to prevail on a claim for intentional infliction of emotional distress, four elements must be established:

> (1) that the defendant's conduct was atrocious, intolerable, and so extreme and outrageous as to exceed the bounds of decency; (2) that the defendant acted with the intent to inflict emotional distress, or acted recklessly when it was certain or substantially certain emotional distress would result from his conduct; (3) that the actions of the defendant caused the plaintiff to suffer emotional distress; and (4) that the emotional distress suffered by the plaintiff was so severe that no reasonable person could be expected to endure it.

Tomblin v. WCHS–TV8, 2010 WL 324429, *10 (S.D.W.Va.2010) (quoting *Philyaw v. Eastern Associated Coal Corp.,* 633 S.E.2d 8, Syl. pt. 2 (W.Va.2006)). Intentional or reckless infliction of emotional distress is the same thing as the tort of outrage. *Lovell v. State Farm Mutual Ins. Co.,* 584 S.E.2d 553, 557 n. 10 (W.Va.2003); *see also Travis v. Alcon Laboratories,* 504 S.E.2d 419, 424 (W.Va.1998) ("Intentional or reckless infliction of emotional distress, also called the 'tort of outrage,' is recognized in West Virginia as a separate cause of action.").

"[T]rial courts should first examine the proof presented by the plaintiff to determine if the defendant's conduct may legally be considered "extreme and outrageous." *O'Dell v. Stegall,* 703 S .E.2d 561, 594 (W.Va.2010).

> In evaluating a defendant's conduct in an intentional or reckless infliction of emotional distress claim, the role of the trial court is to first determine whether the defendant's conduct may reasonably be regarded as so extreme and outrageous as to constitute the intentional or reckless infliction of emotional distress. Whether conduct may reasonably be considered outrageous is a legal question, and whether conduct is in fact outrageous is a question for jury determination.

Id.

Plaintiffs have failed to state a prima facie case for intentional infliction of emotional distress. First, the conduct complained of, i.e., the reverse stock split, is not the type of "atrocious," "intolerable," or "outrageous" behavior that exceeds the bounds of decency. Second, plaintiffs cannot show that any emotional distress suffered by them was so severe that it could not be endured by a reasonable person. *See, e.g., Brown v. City of Fairmont,* 655 S.E.2d 563, 569 (W.Va.2007) (holding that improper disbursement of pension benefits to former wife did not make out a claim for intentional infliction of emotional distress because while "resulting financial consequences were doubtless upsetting and worrisome," it did not "cause the kind of emotional upheaval that no reasonable person could be expected to endure.”). For these reasons, the claims for intentional infliction of emotion distress and outrage are dismissed.

G. Count 9: Negligent Infliction of Emotional Distress

***8** A defendant may be held liable for negligently causing a plaintiff to experience serious emotional distress, after the plaintiff witnesses a person closely related to the plaintiff suffer critical injury or death as a result of the defendant's negligent conduct, even though such distress did not result in physical injury, if the serious emotional distress was reasonably foreseeable. *Arbogast v. Nationwide Mutual Insurance Co.,* 427 S.E.2d 461, 466 (W.Va.1993); *Heldreth v. Marrs,* 425 S.E.2d 157 (W.Va.1992). A claim for negligent infliction of emotional distress “is applicable only to limited situations ‘premised on conduct that unreasonably endangers the plaintiff's physical safety or causes the plaintiff to fear for his or her physical safety.’ “ *Tomblin v. WCHS–TV8,* 2010 WL 324429, *10 (S.D.W.Va.2010) (quoting *Brown v. City of Fairmont,* 655 S.E.2d 563, 569 (W.Va.2007)).

This is not a case pertaining “to the threatened health or safety of the plaintiff or a loved one of the plaintiff.” *Brown,* 655 S.E.2d at 569. Given that no such conduct is alleged herein, dismissal of the negligent infliction of emotional distress claim is appropriate.

IV. Conclusion

For the reasons discussed above, the motion to dismiss filed by Crowe is GRANTED. Given the court's ruling herein, it does not consider the additional grounds for dismissal advanced by Crowe. The Clerk is requested to send a copy of this Memorandum Opinion and Order to counsel of record.

IT IS SO ORDERED.

Footnotes

1 Also pending are two motions to dismiss filed by Crowe prior to the filing of the Amended Complaint, (Docs. # 4 and 6), and a motion to stay the scheduling order, (Doc. # 28). All three motions are DENIED as moot.

End of Document

STRATEGIC CAPITAL RESOURCES, INC., a Delaware Corporation, Plaintiff-Appellant, versus CITRIN COOPERMAN & COMPANY, LLP, a New York Limited Liability Partnership, HORTON & COMPANY, LLC, a New Jersey Limited Liability Company, and EDWARD HORTON, Defendants-Appellees.

No. 06-11520

UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

213 Fed. Appx. 842; 2007 U.S. App. LEXIS 243

January 5, 2007, Decided
January 5, 2007, Filed

NOTICE: [**1] NOT FOR PUBLICATION

PRIOR HISTORY: Appeal from the United States District Court for the Southern District of Florida. D. C. Docket No. 03-80349-CV-DTKH.

DISPOSITION: AFFIRMED.

COUNSEL: For Strategic Capital Resources, Inc., Appellant: Steven Neil Lippman, Rothstein Rosenfeldt Adler, Fort Lauderdale, FL.

For Citrin Cooperman & Company, LLP, Horton & Company, LLP, Edward Horton, Appellees: Gary Robert Shendell, Marshall Dennehey Warner Coleman Goggin, FT LAUDERDALE, FL.

JUDGES: Before DUBINA and WILSON, Circuit Judges, and CORRIGAN, * District Judge.

> * Honorable Timothy J. Corrigan, United States District Judge for the Middle District of Florida, sitting by designation.

OPINION

[*843] PER CURIAM:

In this case, plaintiff-appellant Strategic Capital Resources, Inc. filed suit in the Southern District of Florida, invoking the court's diversity jurisdiction, bringing claims of negligence and breach of fiduciary duty against its independent auditor. Defendants in the suit were Citrin Cooperman & Company, LLP; Horton & Company, LLC; and Edward Horton. Before trial, the District Court excluded Strategic's claims pertaining to an earlier time period because they were not sufficiently pleaded. Also, the District Court [**2] entered summary judgment for defendants on Strategic's breach of fiduciary duty claims, holding that an independent auditor does not owe a fiduciary duty to the company it is auditing. Finally, following a bench trial, the District Court held that Strategic failed to establish by a preponderance of the evidence that defendants were negligent with regard to the preparation of an independent audit and their resignation before the audit was complete. Strategic appeals, raising three issues.

I.

The District Court precluded Strategic from pursuing claims that Horton and Horton & Company breached their fiduciary duty and were negligent for conduct prior to the time frame of the disputed independent audit, holding that "Strategic's amended complaint failed to plead even a single fact or claim that adequately placed the defendants on notice that Strategic intended to proceed against the defendants for claims related to Mr. Horton's prior duties as Strategic's accountant." Treating the District Court's decision as a denial of leave to amend the pleadings, we find that the District Court did not abuse its discretion. *Lowe's Home Centers, Inc. v. Olin Corp.*, 313 F.3d 1307, 1314-15 (11th Cir. 2002); [**3] *CNA Financial Corp. v. Brown*, 162 F.3d 1334, 1337 n.4 (11th Cir. 1998).

II.

We review the District Court's entry of summary judgment in favor of defendants on Strategic's breach of fiduciary claims *de novo*, and we affirm.

Though not addressing squarely whether an independent auditor has a fiduciary duty to a client, the Florida Supreme Court [1] has stated that an independent auditor does not have a confidential relationship with the client with an undivided duty of loyalty, but rather assumes a public responsibility, owing ultimate allegiance to the client's creditors, stockholders and the investing public, which requires the auditor to remain totally independent from the client. *KPMG Peat Marwick v. National Union Fire Ins. Co. of Pittsburgh*, 765 So. 2d 36, 38 (Fla. 2000)(citing *United States v. Arthur Young & Co.*, 465 U.S. 805, 817-18, 104 S. Ct. 1495, 79 L. Ed. 2d 826 (1984)). *See generally Motorcity of Jacksonville, Ltd. v. Southeast Bank N.A.*, 83 F.3d 1317, 1340 (11th Cir. 1996)("the mere act of auditing the dealership and sending the summary audit reports does not . . . give rise to a fiduciary duty under Florida law"), *vacated on other* [**4] *grounds sub nom*. *Hess v. F.D.I.C.*, 519 U.S. 1087, 117 S. Ct. 760, 136 L. Ed. 2d 708 (1997); *cf. TSG Water Resources, Inc. v. D'Alba & Donovan Certified Public Accountants, P.C.*, 366 F. Supp. 2d 1212, 1227 (S.D. Ga. 2004)("[g]enerally, an accountant hired to audit the financial statements of a client is not a fiduciary of the client, but rather is required to be independent of the client").

1 A federal court sitting in diversity applies the substantive law of the state in which it sits. *Ferrero v. Associated Materials, Inc.*, 923 F.2d 1441, 1444 (11th Cir. 1991).

[*844] Even assuming that there may be extraordinary circumstances in which a fiduciary relationship between an independent auditor and a client may arise, we determine that based on the facts of this case, no such extraordinary circumstances exist here.

III.

Finally, the District Court's findings of fact and determination on the ultimate question of negligence were not clearly erroneous. *Superior Constr. Co. v. Brock*, 445 F.3d 1334, 1339 (11th Cir. 2006); [**5] *Holton v. City of Thomasville School Dist.*, 425 F.3d 1325, 1350-51 (11th Cir. 2005); *American Dredging Co. v. Lambert*, 153 F.3d 1292, 1295 (11th Cir. 1998).

AFFIRMED.

2014 WL 1720285
Only the Westlaw citation is currently available.

UNPUBLISHED OPINION. CHECK COURT RULES BEFORE CITING.

UNPUBLISHED
Court of Appeals of Michigan.

BANKER & BRISEBOIS CO., Plaintiff–Appellant,
v.
John C. MADDOX, C.P.A., and Silberstein Ungar, P.L.L.C., f/k/a Maddox Ungar Silberstein, P.L.L.C., f/k/a Maddox Ungar, P.L.L.C., f/k/a Ungar & Associates, P.L.L.C., a/k/a Concrete Accounting, Defendants–Appellees.

Docket No. 310993. | April 29, 2014.

Oakland Circuit Court; LC No.2010–115061–CK.

Before: HOEKSTRA, P.J., and SAWYER and GLEICHER, JJ.

Opinion

PER CURIAM.

***1** Banker & Brisebois Company (B & B) is a small, family-owned advertising firm that used the accounting services of John Maddox for nearly a decade, first while he worked at Mathews, Reich, Perna and Rottermond (MRPR) and then when he left to become an equity partner at Silberstein Ungar (SU).[1] At a meeting in 2003, Maddox allegedly promised to “keep an eye” on B & B's controller to ensure that she was not stealing from the company. Four years later, the controller engaged in a two-year-long embezzlement scheme, stealing over $400,000 before committing suicide in 2009. B & B filed suit against Maddox and SU, alleging various claims related to their failure to detect the fraud and advise B & B. The circuit court summarily dismissed B & B's contract, accountant malpractice, and breach of fiduciary duty claims based on the failure to create a genuine issue of material fact.

We affirm the dismissal of B & B's malpractice and fiduciary duty claims. While the circuit court correctly determined that B & B failed to create a triable issue on many of its claimed contractual breaches, the court improperly dismissed this count against SU limited to its duty to notify B & B of potential fraud. The court also should have considered and granted B & B's motion to amend its complaint to add a contractual claim against Maddox, limited to this issue. We therefore vacate the circuit court's orders on this narrow ground and remand for further proceedings.

I. BACKGROUND

B & B is a small company, owned and operated by Harry Gilmore and his children, Lee and Anne Gilmore. For decades, the company accountant was a close family friend who provided a wide range of business consulting services. He took a hands-on role in running B & B, making monthly visits to manage financial affairs and render advice. In the mid–1990s, that accountant became terminally ill and recommended that B & B use the services of Jim Mathews at MRPR. Although Harry claims that he believed MRPR provided the same level of service as the former accountant, the MRPR representatives were rarely on site. MRPR's annual engagement letter indicated that its services were limited to “compil[ing], from information [B & B] provide[d], the annual balance sheet and the related statements of income, retained earnings, and cash flows” and preparing annual tax return forms. The letter advised B & B that MRPR would “not audit or review ... financial statements.”Moreover, MRPR's “engagement [could] not be relied upon to disclose errors, fraud, or illegal acts that may exist.”“However,” the letter continued, MRPR promised to “inform [B & B] of any material errors that come to [MRPR's] attention and any fraud or illegal acts that come to [MRPR's] attention, unless they are clearly inconsequential.”Joel Ungar managed the B & B account on MRPR's behalf until he left the company in the late 1990s. Maddox then took over.

In the late 1990s, B & B hired a family friend, Lou Ann Oles, to serve as the company controller. Oles took over the day-to-day bookkeeping and financial role for B & B. Oles limited the information B & B provided to MRPR to prepare the taxes and annual balance sheet and Maddox agreed that his company had previously requested unnecessarily excessive documentation.

***2** In 2003, Oles's lifestyle suddenly changed; she leased a sports car, began dressing more fashionably, joined a country club, and took expensive vacations. Lee became concerned that Oles was funding this lifestyle by stealing from B & B. He and Harry requested a meeting with Mathews and Maddox. The parties disagree about what happened at that meeting. Maddox averred that Mathews offered to have MRPR representatives come to B & B after-hours to conduct a forensic accounting, but the Gilmores were uncomfortable with that idea. According to Maddox, Mathews also recommended that the Gilmores ask their bank to send duplicate copies of their account statements to their houses so they could personally reconcile the accounts. Maddox avowed at his deposition, "I've never specifically been requested to do anything" regarding suspicious activity on the part of Oles.

The Gilmores, on the other hand, claimed that Mathews and Maddox gave them advice to monitor potential theft, such as having a second person tally checks and inspect the bank statements. They claimed that B & B was already taking these actions. According to the Gilmores, the 2003 meeting concluded with an agreement "that Maddox would closely watch for any signs of fraud in light of B & B's concerns."The parties agree, however, that neither party ever raised concerns about Oles again. The Gilmores never followed up with Maddox or anyone at MRPR or SU to determine if evidence of wrongdoing had been uncovered and neither Maddox nor his associates ever volunteered any information on this subject.

In 2004, Maddox left MRPR to join Ungar at SU, first as a one-half and later one-third equity partner. Using Maddox's and Ungar's history with the B & B account, Maddox convinced B & B to follow him to this new venture. He provided a business card to B & B describing SU as "CPAs and Business Advisors" and listing services similar to those available at MRPR. For the next five years, Maddox provided services on behalf of SU.

In October 2009, Oles committed suicide. In the weeks after her death, B & B discovered that Oles had improperly authorized bonuses for herself and forged Lee Gilmore's signature on checks she wrote to herself. These events began in 2007. Oles absconded with $401,000 over the two-year period. The Gilmores contacted Maddox and he came to B & B's headquarters. Maddox had left SU less than a week before Oles's death to start his own firm and had not taken the B & B account with him, however. Maddox allegedly commented that Oles's failure to give him certain information "raised flags or suspicion with him."The parties disagree whether Maddox was referring to Oles's decision in the late 1990s to limit MRPR's access to B & B financial records or her conduct since the 2003 meeting.

B & B filed suit against Maddox and SU for failing to discover and notify B & B about Oles's activities. They alleged that while Maddox worked with MRPR, he provided "accounting and tax preparation services for both B & B and the Gilmores, overseeing B & B's bookkeeping department, advising B & B on general and day-to-day concerns regarding employees, healthcare and many other issues, and handling corporate entity changes for B & B." B & B alleged that Maddox continued to provide these services at SU and, "[i]n addition, Maddox began to assume even more comprehensive and complex financial and business undertakings on behalf of B & B and the Gilmores, rendering evaluations and advice with regard to general business, profitability, and employee matters."B & B also cited the 2003 meeting after which it alleged that "it was agreed that Maddox would keep a close eye on Oles and the corporate books for anything suspicious or out of the ordinary that might point to embezzlement from the Company."After Oles's death, according to B & B, Maddox suddenly and falsely asserted that he had only ever provided tax services to the company and had no role in monitoring Oles. Despite suspicions cited by Maddox and e-mail correspondence showing that the numbers presented by Oles were not always accurate and that Oles was hesitant to provide supporting documentation, Maddox never reported back to the Gilmores.

***3** B & B alleged accountant malpractice against Maddox and SU based on their failure to monitor Oles's activities despite the "specific[ ] assign [ment]" of that task at the 2003 meeting, "to detect approximately $401,000 in fraudulent checks" written by Oles, to follow up with B & B and warn the company of Oles's suspicious behavior and accounting errors, and "to institute even the most basic of safeguards or fraud protection with regard to Oles'[s] job performance." B & B also alleged that Maddox and SU breached their fiduciary duties to B & B. B & B asserted that the fiduciary duty arose "[b]y virtue of the accountant-client relationship ... as [B & B's] certified public accountant and financial and business advisor."B & B cited the same conduct amounting to malpractice in support of these counts. B & B finally raised a breach of contract claim against SU alone. In relation to this count, B & B alleged:

> 52. Plaintiff, B & B, entered into an agreement in the late 1990's with the Accounting Firm for the performance of accounting, tax preparation, and business advisory services on B & B's and the Gilmore's behalf.
>
> 53. The Accounting Firm further agreed in 2003 to safeguard and protect the Company from embezzlement by

> taking protective measures including monitoring Oles'[s] business activities in light of her significant lifestyle change.

B & B claimed to have paid SU $161,502.50 for its services from 1997 through 2009. [2] And yet, B & B alleged, SU "failed to safeguard and protect the Company by taking protective measures including monitoring Oles' [s] business activities, and as a result Oles was able to embezzle without detection $401,000 from B & B between August 7, 2007 and October 23, 2009."

Following discovery, Maddox and SU sought summary disposition of these claims pursuant to MCR 2.116(C)(8) and (10). After separate hearings and relying on (C)(10), the circuit court dismissed B & B's complaint in its entirety. In relation to SU, the court noted, "Essentially, [B & B] seeks to hold [SU] liable for a 2003 promise allegedly made by the Defendant, John Maddox, wherein he would keep a close eye on [B & B's] bookkeeper."The court found "no evidence of a fiduciary duty between" SU and B & B and opined that B & B "blurs the distinction between the separate Defendants" in making this claim. In relation to B & B's accountant malpractice claim against SU, the court stated, "The failure to perform allegedly contracted for services gives rise to a contract and not a tort or a malpractice cause of action."Again, the court noted that B & B's claim was based on the 2003 promise made by Maddox to watch Oles and the argument that SU "was somehow obligated to oversee Olds [sic] and failed to do so."This sounded in breach of contract, not malpractice, according to the court. Moreover, the court could find no duty on SU's part based on a contract made in the mid–1990s before SU was formed and with no SU principal in attendance. The court also dismissed the breach of contract claim, ruling "there's no evidence binding this Defendant to a commitment made by a member of MRPR in 2003, let alone that it was breached."

***4** The court later dismissed B & B's claims against Maddox based on MCR 2.116(C)(10) in a terse fashion. In relation to the breach of fiduciary duty claim, the court concluded, "[T]he evidence does not create a question of fact as to whether Defendant Maddox had any fiduciary duty to [B & B], let alone that he breached the same."The court further determined that "the evidence presented does not create a question of fact as to the elements of" the malpractice claim. The court continued, B & B's "claim is grounded on an alleged promise made by Maddox. However, the failure to perform allegedly contracted for services gives rise to a contract and not a tort in malpractice."The court could not consider a breach of contract claim against Maddox because B & B had not raised it. This appeal followed.

II. STANDARD OF REVIEW

The circuit court granted Maddox's and SU's motions for summary disposition based on MCR 2.116(C)(10). We review de novo that decision. *Edry v. Adelman,* 486 Mich. 634, 639; 786 NW2d 567 (2010).

> A motion under MCR 2.116(C)(10)"tests the factual support of a plaintiff's claim."*Walsh v. Taylor,* 263 Mich.App 618, 621; 689 NW2d 506 (2004)."Summary disposition is appropriate under MCR 2.116(C)(10) if there is no genuine issue regarding any material fact and the moving party is entitled to judgment as a matter of law ."*West v. Gen Motors Corp,* 469 Mich. 177, 183; 665 NW2d 468 (2003)."In reviewing a motion under MCR 2.116(C)(10), this Court considers the pleadings, admissions, affidavits, and other relevant documentary evidence of record in the light most favorable to the nonmoving party to determine whether any genuine issue of material fact exists to warrant a trial."*Walsh,* 263 Mich.App at 621. "A genuine issue of material fact exists when the record, giving the benefit of reasonable doubt to the opposing party, leaves open an issue upon which reasonable minds might differ."*West,* 469 Mich. at 183. *[Zaher v. Miotke,* 300 Mich.App 132, 139–140; 832 NW2d 266 (2013).]

III. FIDUCIARY DUTY

B & B challenges the circuit court's conclusion that neither Maddox nor SU owed it a fiduciary duty. "Whether to recognize a cause of action for breach of fiduciary duty is a question of law reviewed de novo, because the existence of a duty is generally a question of law."*Calhoun Co v. Blue Cross & Blue Shield of Mich,* 297 Mich.App 1, 20; 824 NW2d 202 (2012).

We first consider defendants' argument that the accountant malpractice statute, MCL 600.2962, abrogates the common law and creates the lone cause of action for accountant errors, thereby precluding any claim based on the breach of a fiduciary duty.

The common law remains in force until "changed, amended or repealed." Whether the Legislature has abrogated, amended, or preempted the common law is a question of legislative intent. We will not lightly presume that the Legislature has abrogated the common law. Nor will we will extend a statute by implication to abrogate established rules of common law. "Rather, the Legislature 'should speak in no uncertain terms' when it exercises its authority to modify the common law."[*Velez v. Tuma,* 491 Mich. 1, 11–12; 821 NW2d 432 (2012) (citations omitted).]

***5** MCL 600.2962"applies to an action for professional malpractice against a certified public accountant."MCL 600.2962(1). The statute by its own language does not apply to other actions against an accountant. The statute's second sentence—"A certified public accountant is liable for civil damages in connection with public accounting services performed by the certified public accountant only in 1 of the following situations"—must be read in harmony with the first. See *Frank v. William A Kibbe & Assocs, Inc,* 208 Mich.App 346, 350–351; 527 NW2d 82 (1995) ("In construing a statute, the court should presume that every word has meaning and avoid a construction which would render a statute, or any part of it, surplusage or nugatory."), *id.* at 354 ("Provisions must be read in the context of the entire statute so as to produce a harmonious whole."). Under the plain language of the statute, an accountant's *malpractice* liability is limited to the circumstances described in the statute, but other causes of action against an accountant remain intact. [3]

The circuit court correctly determined, however, that neither Maddox nor SU had a fiduciary relationship with B & B. " 'Fiduciary relationship' is a legal term of art," defined by our Supreme Court as follows:

"[A] relationship in which one person is under a duty to act for the benefit of the other on matters within the scope of the relationship. Fiduciary relationships—such as trustee-beneficiary, guardian-ward, agent-principal, and attorney-client—require the highest duty of care. Fiduciary relationships [usually] arise in one of four situations: (1) when one person places trust in the faithful integrity of another, who as a result gains superiority or influence over the first, (2) when one person assumes control and responsibility over another, (3) when one person has a duty to act for or give advice to another on matters falling within the scope of the relationship, or (4) when there is a specific relationship that has traditionally been recognized as involving fiduciary duties, as with a lawyer and a client or a stockbroker and a customer."[*In re Karmey Estate,* 468 Mich. 68, 74 n 2; 658 NW2d 796 (2003), quoting *Black's Law Dictionary* (7th ed) (second alteration in original).]

" '[A] fiduciary relationship arises from the reposing of faith, confidence, and trust and the reliance of one on the judgment and advice of another.'However, the placement of trust, confidence, and reliance must be reasonable....'" *Prentis Family Foundation, Inc v. Barbara Ann Karmanos Cancer Institute,* 266 Mich.App 39, 43–44; 698 NW2d 900 (2005) (citations omitted, alteration in original).

Common examples this Court has recognized include where a patient makes a will in favor of his physician, a client in favor of his lawyer, or a sick person in favor of a priest or spiritual adviser. In these situations, complete trust has been placed by one party in the hands of another who has the relevant knowledge, resources, power, or moral authority to control the subject matter at issue.*[Karmey,* 468 Mich. at 74 n 3 (citation omitted).]

***6** B & B cannot establish a fiduciary relationship in this case. First, the accountant-client relationship is not a traditionally recognized fiduciary relationship. There is no Michigan caselaw holding that an accountant generally owes a fiduciary duty to his or her clients. Rather, Michigan, as with other states, only finds a fiduciary relationship when special facts support such a heightened duty. See *Shwayder Chem Metallurgy Corp v. Baum,* 45 Mich.App 220; 206 NW2d 484 (1973) (finding a fiduciary relationship where the accountant began as a private consultant but was then hired as the plaintiff company's business manager). See also *Vtech Holdings Ltd v. Price WaterhouseCoopers, LLP,* 348 F Supp 2d 255, 268 (SD NY, 2004) ("In New York, the accountant-client relationship does not generally give rise to a fiduciary relationship absent special circumstances, such as the accountant's commission of active fraud on the client. Even the existence of a consulting relationship does not automatically establish a fiduciary relationship."); *Fleet Nat'l Bank v. H & D Entertainment,* 926 F Supp 226, 242 (D Mass, 1994) ("Where an accountant merely performs basic accounting functions, no fiduciary relationship is created."); *Iacurci v. Sax,* 139 Conn App 386, 405; 57 A3d 736 (2012) (holding that no fiduciary relationship is created when the accountant simply prepares the client's yearly tax returns, but may arise when the accountant "undertake[s] tasks such as managing the plaintiff's funds, advising the plaintiff with regard to investments or recommending financial transactions.").

No one at MRPR or SU was socially acquainted with the B & B principals. At no time did B & B hire Maddox as an in-house employee. This case is therefore inapposite of *Shwayder Chem.* Neither Maddox nor SU committed fraud against their client. While Maddox and SU provided professional advice when requested by B & B beyond the mere preparation of tax returns, the creation of a fiduciary relationship would be attenuated in this case. Accordingly, B & B cannot prove a fiduciary relationship under the fourth *Karmey* factor-the existence of a traditionally recognized fiduciary relationship.

B & B also cannot show that a fiduciary duty arose based on the second *Karmey* factorassumption of control or responsibility. There is no record indication that Maddox or SU took control or responsibility over B & B in any fashion. B & B always maintained in-house bookkeepers and financial staff. B & B acknowledged that the MRPR and SU representatives took a much more hands-off approach with the company than had its previous accountant. Although Lee Gilmore averred at his deposition that "MRPR was overseeing the accounting department," he later acknowledged that this statement was not supported by the evidence. Accepting B & B's evidence as true, the most Maddox and SU did was provide advice on various business matters. Such advice could be freely rejected by B & B, negating a fiduciary relationship under this factor.

***7** B & B also did not create a genuine issue of material fact that a fiduciary relationship arose because it "place[d] trust in the faithful integrity of [Maddox and SU], who as a result gain[ed] superiority or influence over" it. While the Gilmores alleged that they placed their trust in Maddox and SU as their accountants, they have not pleaded or raised facts raising the trust to the level of a fiduciary relationship. The placement of trust must be reasonable in a fiduciary relationship. See *Prentis Family Foundation,* 266 Mich.App at 43–44. B & B's trust that Maddox and SU would monitor Oles and uncover her fraud was unreasonable under the circumstances. B & B knew that Maddox was not conducting day-to-day or even monthly financial review of the company. Reconciling bank statements was their job, Harry and Lee Gilmore admitted. Despite their previous concerns about Oles's integrity, they completely entrusted that task to her and stopped overseeing her work. Without access to B & B's bank statements and detailed company records regarding income and expenses, neither Maddox nor SU had any way to discover the particular fraud perpetrated by Oles. Moreover, even if Maddox promised at the 2003 meeting to "keep an eye on" Oles, it was unreasonable for B & B to believe that Maddox had continued such oversight four years later when neither party ever followed up to discuss the issue. Furthermore, it was not reasonable for B & B to rely on Maddox's vague statement that he would monitor Oles, to mean that he would put fraud prevention safeguards into place, or conduct forensic accounting services to detect fraud. Such services would have been expensive and the Gilmores should have noticed that no bill was forthcoming.

Similarly, B & B cannot establish that Maddox or SU "ha[d] a duty to act for or give advice to" it regarding Oles's fraud. Oles did not begin her embezzlement scheme until four years after Maddox allegedly promised to keep an eye on her. Even the Gilmores acknowledge that they uncovered no evidence that Oles was committing any type of fraud in 2003, when their suspicions were piqued. By 2007, B & B's fears were so allayed that it allowed Oles to function alone as the accounting department with no employees or supervisors to interfere with or even notice her illegitimate acts. As the fear of fraud was seemingly a thing of the past, B & B cannot show that an eternally continuing duty to oversee Oles was a "matter[ ] falling within the scope of the relationship" between the accountant and client. The circuit court therefore properly dismissed B & B's fiduciary duty claims against Maddox and SU.

IV. MALPRACTICE

The circuit court dismissed B & B's malpractice claims against Maddox and SU because they were based on Maddox's alleged breach of the 2003 promise to keep an eye on Oles. The breach of such a promise is based in contract, not tort, ruled the court. The court also ruled that the evidence presented by B & B did not create a genuine issue of material fact on the elements of a malpractice claim.

***8** The circuit court correctly ruled that in order for a "tort" action to stand, " '[t]here must be some breach of duty distinct from breach of contract.' " *Rinaldo's Constr Corp v. Mich. Bell Tel Co,* 454 Mich. 65, 83; quoting *Hart v. Ludwig,* 347 Mich. 559, 563; 79 NW2d 895 (1956). An accountant-client relationship, like many other business relationships, however, is born from a contract. The contract encompasses a duty to provide certain services or do certain acts. It also encompasses a duty to perform the services and acts underlying the contract with due care. Malpractice arises from the breach of the duty of care owed to the client under the contract.*Saur v. Probes,* 190 Mich.App 636, 638; 476 NW2d 496 (1991); *Malik v. William Beaumont Hosp,* 168 Mich.App 159, 168; 423 NW2d 920 (1988). The duty of care is separate and distinct from the contractual duty to provide services and therefore a plaintiff can raise both tort and breach of contract claims in one action.

In relation to an action arising out of subpar medical care, our Supreme Court described the difference between the malpractice and contract actions that could be raised:

> "The 2 causes of action are dissimilar as to theory, proof and damages recoverable. Malpractice is predicated upon the failure to exercise requisite medical skill and is tortious in nature. The action in contract is based upon a failure to perform a special agreement. Negligence, the basis of the one, is foreign to the other. The damages recoverable in malpractice are for personal injuries, including the pain and suffering which naturally flow from the tortious act. In the contract action they are restricted to the payments made and to the expenditures for nurses and medicines or other damages that flow from the breach thereof."[*Stewart v. Rudner,* 349 Mich. 459, 468; 84 NW2d 816 (1957) (citation omitted).]

Here, B & B's malpractice and contract claims were based on separate theories-the malpractice claim was based on the idea that Maddox and SU failed in their duties to adequately protect and advise their client, and the contractual claim was based on a failure to take specific agreed-upon actions. Although the malpractice claim arose from contracted-for services, it is not precluded. Accordingly, the circuit court erred in dismissing B & B's malpractice claims on this ground.

The question remains whether B & B created a genuine issue of material fact that Maddox and SU committed accountant malpractice. "Professional malpractice involves the breach of a duty owed by one rendering professional services to a person who has contracted for such services."*Saur,* 190 Mich.App at 638. In order to state a claim for malpractice, a plaintiff must allege (1) the existence of a professional relationship; (2) negligence in the performance of the duties within that relationship; (3) proximate cause; and (4) the fact and extent of the client's injury. See *Simko v. Blake,* 448 Mich. 648, 655; 532 NW2d 842 (1995) (defining legal malpractice).MCL 600.2912a provides, in relevant part, for a defendant's malpractice liability:

> ***9** (1) ... [I]n an action alleging malpractice, the plaintiff has the burden of proving that in light of the state of the art existing at the time of the alleged malpractice:
>
> (a) The defendant, if a general practitioner, failed to provide the plaintiff the recognized standard of acceptable professional practice or care in the community in which the defendant practices or in a similar community, and that as a proximate result of the defendant failing to provide that standard, the plaintiff suffered an injury.

MCL 600.2962 more specifically addresses accountant malpractice, in relevant part, as follows:

> (1) This section applies to an action for professional malpractice against a certified public accountant. A certified public accountant is liable for civil damages in connection with public accounting services performed by the certified public accountant only in 1 of the following situations:
>
> (a) Subject to subsection (2), a negligent act, omission, decision, or other conduct of the certified public accountant if the claimant is the certified public accountant's client. [4]

B & B presented evidence that within the confines of their professional relationship, Maddox agreed to monitor Oles and report back to B & B with any suspicious or concerning information. B & B also presented evidence that it expected Maddox and SU to continue MRPR's services, which included notifying B & B of "material errors" uncovered during the course of its work. Although Maddox denies that such an oral promise was made in 2003, we are bound at the summary disposition phase to accept the nonmoving party's evidence as true. Neither Maddox nor SU deny the more general duty.

B & B also presented sufficient evidence that Maddox breached his duty of due care to survive summary disposition. In 2006 and 2009, Maddox or other SU employees discovered accounting errors in the information provided by B & B. In both years, Maddox or the employees requested to review B & B's general ledger, both to investigate the errors and to prepare B & B's personal property tax return. Oles rejected Maddox's requests, instead providing e-mail explanations for the errors and a summary report for tax preparation purposes. Yet, Maddox never raised any concerns with the Gilmores. Again, we are bound to interpret the evidence in B & B's favor. If not for this limitation, we would find no breach given that four years had elapsed since the Gilmores' initial concerns with Oles's activities, no follow-up conversation ever occurred between B & B and its accountant, and B & B essentially allowed Oles to become a one-woman accounting department suggesting that their concerns had been assuaged. Under these circumstances, we would discern no negligence in the failure to report the 2006 and 2009 incidents. And following the MRPR engagement letter, which B & B believed bound Maddox and SU, Maddox complied by notifying the B & B accounting department, i.e. Oles, of the errors discovered.

***10** In any event, B & B cannot create a genuine issue of material fact that Maddox's and SU's failure to report the 2006 and 2009 incidents was a proximate cause of its losses. Oles committed embezzlement in two ways: through fraudulent pay bonuses and forged checks. The fraudulent bonuses were processed through B & B's private human resources vendor. Maddox and SU had no connection or contact with that vendor. Maddox and SU never reviewed records from that source. Accordingly, Maddox and SU had no way to discover the fraudulent bonuses.

The forged checks could only be discovered by reconciling B & B's accounts. In 2007, the last employee under Oles's supervision left and B & B did not replace her. Oles then changed the method by which B & B received its bank account statements from paper to on-line. Although Lee claimed he had always reviewed those statements, the Gilmores never noticed that they stopped receiving the statements. Maddox and SU would have no way to know about this change in internal operating procedures at B & B. Maddox and SU did not have access to the company's safe where the paper checks were housed to discover that any were unaccounted for. The only way any accountant—MRPR, Maddox or SU—could have discovered the fraud was if they reconciled B & B's bank accounts against the general ledger, a task that was never assigned to them. Investigation into the accounting errors discovered by Maddox and other SU employees would not have led to discovery of Oles's embezzlement scheme. Neither would the production of B & B's general ledger absent the bank statements.

As defendants could not have discovered the embezzlement or protected against it, they cannot be the proximate cause of B & B's injuries. The circuit court therefore correctly dismissed these claims.

V. BREACH OF CONTRACT

B & B also challenges the circuit court's dismissal of its breach of contract claim against SU. This claim arose out of the mid–1990s contract with MRPR and Maddox's 2003 promise to keep an eye on Oles. B & B contended that these contracts followed Maddox to SU as he and Ungar convinced B & B to follow Maddox to SU. SU thereby promised to continue the services being provided to B & B by Maddox at MRPR.

"The existence and interpretation of a contract are questions of law reviewed de novo."*Kloian v. Domino's Pizza LLC,* 273 Mich.App 449, 452; 733 NW2d 766 (2006)."There are five elements of a valid contract: (1) parties competent to contract, (2) a proper subject matter, (3) a legal consideration, (4) mutuality of agreement, and (5) mutuality of obligation."*Calhoun Co,* 297 Mich.App at 13 (quotation marks and citation omitted). There must be "a meeting of the minds on all essential terms of a contract" and without this "a contract does not exist." *Id.* (quotation marks and citation omitted). Whether there is a meeting of the minds "is judged by an objective standard, looking to the express words of the parties and their visible acts, not their subjective states of mind."*Id.* (quotation marks and citation omitted).

***11** First and foremost, the circuit court erred in concluding that Maddox did not have the power to bind SU to the contract entered by MRPR in the 1990s and the promise he made to B & B in 2003. In a partnership, each partner has the right to manage and conduct the partnership business, including the right to create obligations. Crane & Bromberg, Law of Partnership (1968), § 48, pp 272–273. Each partner acts as a principal and as an agent for the partnership.*Id.* at 273.See also *Hunt v. Erikson,* 57 Mich. 330, 333; 23 NW 832 (1885) ("[I]f they ... stand to each other in the relation of principals, and in carrying on the business of the firm act merely as its agents, then a partnership does exist.")."Under the general mutual agency among partners, the act of every partner within the apparent scope of partnership business binds the partnership...." Henn & Alexander, Laws of Corporations (3d ed), § 22, p 70. See also *Wexford Twp v. Seeley,* 196 Mich. 634, 641; 163 NW 16 (1917) (emphasis added) ("The rule is too well established to need citation of authorities that one partner cannot bind his copartner by any contract *without* the scope of the partnership, that each partner is the agent for his copartners in the transaction of the business of the copartnership, but *not as to matters foreign to such business.");*MCL 449.9(1) ("Every partner is an agent of the partnership for the purpose of its business, and the act of every partner, including the execution in the partnership name of any instrument, for apparently carrying on in the usual way the business of the partnership of which he is a member binds the partnership....”).

Maddox acted within the scope of partnership business when he convinced B & B to move their business from MRPR to SU and when he told B & B that this was a sound decision because he and Ungar had both worked on the B & B account and knew its business. This could be reasonably understood as a promise to continue the services Maddox and MRPR had been providing. Accordingly, SU was liable under contract to provide the services that MRPR had been contractually bound to provide. This would include the preparation of tax returns and the annual balance sheet as described in the MRPR engagement letter. Accepting as true that Maddox promised in 2003 to keep an eye on Oles, that contract would also bind SU.

B & B further created a genuine issue of material fact that a contract existed and that SU breached its contractual obligations. Defendants do not dispute that the parties were competent to contract, that accounting services are a proper subject matter, and that B & B paid for the services as it was obliged to do. The dispute arises over the mutuality of agreement regarding the nature of the contracted-for services.

Defendants claim that SU was only obligated to provide tax return services to B & B. Defendants point to the November 16, 2004 letter sent by Harry Gilmore to MRPR to advise it that B & B would be terminating its services. Specifically, the letter indicated, “We have engaged [SU] to prepare our tax returns for 2004.”B & B presented evidence refuting that claim, however. Maddox admitted that he recommended a human resources vendor to B & B while working for SU. B & B placed into the record various invoices describing services beyond tax preparation, such as “assistance with accounting for capital lease,” “review equipment lease,” “discussing accounting software options,” securing health insurance quotes, “go[ing] over health insurance software,” advising on the distribution of employee bonuses, and participating in a 2008 “meeting re finances of the company.”In a 2008 e-mail, Maddox provided to Anne and Lee Gilmore “comments and suggestions relative to the B & B current compensation plan and financial condition.”These services clearly went beyond the mere preparation of tax returns.

***12** The breaches described by B & B are the failure to monitor Oles and the failure to notify the Gilmores of material errors or evidence of fraud. B & B implies that the accounting errors described in various e-mails between Oles and SU employees were material and should have been disclosed. B & B further implies that Oles's unwillingness to provide the general ledger and other documentation were signs of potential fraud that SU should have reported. B & B also cited the failure to “institute[ ] even the most basic of safeguards or fraud protection with regard to the specific task of monitoring Oles.”

The accounting errors described in the e-mail correspondence were likely immaterial and appear to have been remedied after discussions with Oles. Moreover, B & B presented no evidence that the agreement to “keep an eye” on Oles required the imposition of safeguards or fraud protection. Yet, the evidence creates a triable issue whether SU breached its duty to notify B & B of potential fraud. While Maddox claimed in his deposition that Oles's unwillingness to provide additional documentation was not concerning, the Gilmores swore that Maddox contradicted this statement in their conversation after Oles's death. Accordingly, whether the failure to notify B & B of these refusals is a question for the fact finder. The circuit court therefore erred in granting summary disposition in SU's favor on this limited issue. We vacate that portion of the summary dismissal order and remand for further proceedings.

IV. AMENDMENT OF COMPLAINT

Finally, B & B challenges the circuit court's failure to address its request to amend its complaint in its response to defendants' motions for summary disposition. Specifically, B & B wanted to add a breach of contract claim against Maddox individually. We review for an abuse of discretion a circuit court's decision on a motion for leave to amend a pleading. *Casey v. Auto Owners Ins Co,* 273 Mich.App 388, 400–401; 729 NW2d 277 (2006).

Generally, a party may amend its complaint as a matter of right. *Ben P Fyke & Sons v. Gunter Co,* 390 Mich. 649, 659; 213 NW2d 134 (1973). “Leave shall be freely given” for an amendment “when justice so requires.” MCR 2.118(A)(2). Leave to amend should be denied only in limited situations such as where the amendment would cause undue delay, the party seeking amendment is acting in bad faith or has failed to cure pleading deficiencies after repeated amendments, or when the amendment would be futile. *In re Kostin,* 278 Mich.App 47, 52; 748 NW2d 583 (2008). Moreover, when a court dismisses a plaintiff's claims under MCR 2.116(C)(10), “the court shall give the parties an opportunity to amend their pleadings as provided by MCR 2.118, unless the evidence then before the court shows that amendment would not be justified."MCR 2.116(I)(5).

In this case, the circuit court ignored B & B's amendment request. As noted above, B & B had a limited contractual cause of action against SU. That same claim could be raised against Maddox individually. This is the first amendment B & B requested and there is no apparent dilatory motive. Accordingly, on remand, the circuit court should grant B & B's motion.

***13** We affirm in part, vacate in part, and remand for further proceedings consistent with this opinion. As neither party prevailed in full, costs may not be taxed. MCR 7.219. We do not retain jurisdiction.

Footnotes

1 The accounting firm frequently changed names depending on the identity of the equity partners at any given time. For ease of reference, we refer to the firm by its most recent name.

2 In the complaint, B & B did not seem to appreciate that SU was an entirely separate entity from MRPR and did not take B & B as a client until 2004.

3 We acknowledge that the federal district court for the eastern district of Michigan reached a contrary result in *Yadlosky v. Grant Thornton, LLP,* 120 F Supp 622, 634 (ED Mich, 2000). We are not bound by federal decisions interpreting Michigan law. *Van Buren Charter Twp v. Garter Belt, Inc,* 258 Mich.App 594, 604; 673 NW2d 111 (2003).

4 Subsection (2) limits liability when the claimant is not a client of the accountant.

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2015 WL 1396382
Only the Westlaw citation is currently available.
Court of Chancery of Delaware.

The Honorable Karen Weldin Stewart, CIR–ML, Insurance Commissioner of the State of Delaware, in Her Capacity as the Receiver of Security Pacific Insurance Company, Inc. in Liquidation, SPI–202, Inc. in Liquidation, SPI–203, Inc. in Liquidation, and SPI–204, Inc. in Liquidation, Plaintiff,
v.
Wilmington Trust SP Services, Inc., Johnson Lambert & Co., LLP, Johnson Lambert, LLP, McSoley McCoy & Co., James M. Jackson, Paul D. King, Kevin R. Davis, and Stephen D. Kantner, Defendants.

C.A. No. 9306–VCP | Submitted: November 20, 2014 | Decided: March 26, 2015

Attorneys and Law Firms

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OPINION

PARSONS, Vice Chancellor.

***1** The key issue in this Opinion is when, under Delaware law, a corporation may state claims against third parties, like auditors, who are implicated in the alleged misconduct of the corporation's directors and officers. The plaintiffs here are four Delaware-domiciled captive insurance companies, with the Insurance Commissioner of the State of Delaware prosecuting their claims as their receiver in liquidation. The complaint alleges an array of fraudulent conduct on the part of the four companies' president, CEO, and sole stockholder. The other directors of the corporations also are alleged to have breached their fiduciary duties by either assisting or failing to catch and report those fraudulent acts.

As relevant here, the complaint also includes claims against the companies' auditors and their administrative management company for breaches of fiduciary duty, breach of contract, negligence, and aiding and abetting breaches of fiduciary duty. Those defendants moved to dismiss, contending that the wrongdoing of the companies' officers and directors is imputed to each of the corporations themselves, and that the doctrine of *in pari delicto* bars the court from intervening to adjudicate claims between wrongdoers. In addition, the moving defendants seek dismissal of the claims against them based on the defense of laches and for failure to allege the necessary elements of certain of the putative causes of action. The receiver disputes the applicability of these defenses and denies that *in pari delicto* should bar her claims for several different reasons.

I first conclude that Delaware law governs the entirety of the pending motions. Next, I reject the moving defendants' laches defense as without merit in the circumstances of this case. After that, I briefly address the motions of the auditors, the administrative management company, and its defendant-employee to dismiss the various claims for breach of fiduciary duties. I grant this aspect of the motions as to those defendants, except the defendant-employee who was a director of the plaintiff insurance companies. I then take up the issue of whether *in pari delicto* requires dismissal of the remaining claims.

For the reasons stated in this Opinion, I conclude that *in pari delicto* does apply in this case, and that it effectively would bar the relevant claims against the moving defendants, unless

I found applicable one of the exceptions urged by the receiver. In the circumstances of this case, the well-known "adverse interest" exception does not apply. The receiver also contends that the Court should set aside the *in pari delicto* doctrine on public policy grounds tied to the specific concerns involved in the insurance receivership context. But, I conclude that the facts of this case do not support such a result.

Finally, I address the argument that Delaware law should recognize an "auditor exception" to the *in pari delicto* rule, as some states have done. Because I do not read the applicable Delaware cases as supporting the conclusion the receiver urges, and I am not convinced that Delaware public policy would be well-served by a broad auditor exception, I reject that argument as it relates to the claims for breach of contract and negligence and dismiss those claims on grounds of *in pari delicto.* I decline to dismiss the claims for aiding and abetting a breach of fiduciary duty on that basis, however, because I conclude, based on Delaware case law and the relevant policy concerns, that the well-established "fiduciary duty" exception to *in pari delicto* would cover those claims.

***2** Finally, I examine the aiding and abetting claims against each of the auditors and the administrative management company. Based on the allegations in the Complaint, I deny the motions to dismiss those claims, except as they relate to the auditor that was retained second.

I. BACKGROUND [1]

A. The Parties

This case concerns Security Pacific Insurance Company, Inc. ("Security Pacific"), SPI–202, Inc. ("SPI–202"), SPI–203, Inc. ("SPI–203"), and SPI–204, Inc. ("SPI–204," and collectively, the "SPI Entities"). All of the SPI Entities are Delaware corporations. From December 31, 2007, to June 15, 2011, they operated as Delaware-domiciled special purpose captive insurance companies.

On June 15, 2011, this Court entered an order in a related action placing the SPI Entities into liquidation pursuant to 18 *Del. C.* § 5906 (the "Liquidation Action"). [2] Plaintiff in this action is the Honorable Karen Weldin Stewart, the Insurance Commissioner of the State of Delaware, who brings this action as Receiver of the SPI Entities in liquidation. The Complaint initially named eleven Defendants: Wilmington Trust SP Services, Inc. ("Wilmington Trust"); Johnson Lambert & Co., LLP; Johnson Lambert, LLP; McSoley McCoy & Co. ("McSoley McCoy"); Ryan Building Group, Inc. ("Ryan Building Group"); Kevin R. Davis; James M. Jackson; James L. Jackson; Stephen D. Kantner; Paul D. King; and Anthony P. Muñoz. [3]

As relevant to this Opinion, Wilmington Trust, a Delaware corporation with its principal place of business in Wilmington, Delaware, provided management and administrative services to the SPI Entities. Defendant Kantner, an individual residing in Delaware, was an employee of Wilmington Trust and also a member of the boards of directors of the four SPI Entities. Johnson Lambert & Co., LLP, is a South Carolina limited liability partnership based in South Carolina, and Johnson Lambert, LLP, is a Virginia limited liability partnership based in North Carolina (together, "Johnson Lambert"). [4] As discussed in further detail below, Johnson Lambert and McSoley McCoy, a Vermont corporation with its principal place of business in Vermont, each provided certified public accountant and independent auditor services to the SPI Entities. Currently before the Court are motions to dismiss filed by Johnson Lambert and McSoley McCoy (together, the "Auditor Defendants"), and by Wilmington Trust and Kantner (collectively, the "Moving Defendants").

B. Facts

1. The SPI Entities

***3** In 2005, Defendant James M. Jackson formed Security Pacific Insurance Company, Inc., as a captive insurance company incorporated in the District of Columbia ("SPIC–DC"). In general terms, a "captive insurance company" is a business entity formed as a subsidiary of a non-insurance parent company for the purpose of insuring the parent's business risk, or the risk of the parent's affiliates or customers. It is a self-insurance mechanism in which the insurer is wholly owned by the insured. In the State of Delaware, captive insurance companies, like all commercial insurers, are subject to extensive regulatory oversight and requirements, ranging from licensure and reporting to minimum capital and reserve thresholds. [5]

Jackson, [6] through a wholly owned holding company, was the sole owner of SPIC–DC. He also owned an insurance brokerage company, nonparty J. Mading Financial and Insurance Services, Inc. ("J. Mading"), which, in collaboration with SPIC–DC, designed and marketed insurance solutions using captive insurance companies. For example, Ryan Building Group, a client of J. Mading's, was insured by a subsidiary of SPIC–DC, and nonparty OOM, LLC was insured by another. Those two clients, which engaged in residential construction, apparently entered into participation agreements by which SPIC–DC and its "cells," or subsidiary captives, would provide warranty reimbursement, general liability, property, excess, and environmental liability insurance coverage.

Beginning in July 2007, Jackson sought to re-domicile SPIC–DC and its subsidiary cells to Delaware. According to Jackson's plan, SPIC–DC would merge into Security Pacific, the Delaware corporation at issue in this case, and SPIC–DC's cells would merge into the newly incorporated SPI–202 and SPI–203 entities. SPI–204 would be created to insure the risk of Alexa Holding Company, LLC, another entity solely owned by Jackson. Pursuant to the relevant statutory provisions, Jackson submitted an application for authorization to the Delaware Department of Insurance ("DDOI"). In the application documents, Jackson represented that the SPI Entities would hold initial capital amounts, in the aggregate, of roughly $2.7 million, with some additional reserves in the form of letters of credit. [7] Included in these application documents were SPIC–DC's audited financial statements covering the time period from its inception in 2005 to December 31, 2006, which reported that SPIC–DC had total assets of roughly $4.8 million. [8] Those audited financial statements were prepared and certified by Johnson Lambert.

In October 2007, SPIC–DC entered into a Management Services Agreement (the "MSA") with Wilmington Trust, whereby Wilmington Trust agreed to serve as Security Pacific's "captive manager" in Delaware by providing administrative, compliance, and other related services. [9] Wilmington Trust also would ensure that the SPI Entities conformed with certain statutory requirements, by, for example, providing a "place of business" in Delaware, and retaining all of the SPI Entities' original documentation and books and records here. [10] Consistent with the legal requirements, Defendant Kantner, who was employed as an Accounting Supervisor at Wilmington Trust, served as a "resident" director on the boards of each of the SPI Entities. [11]

***4** As relevant here, the captive management services provided by Wilmington Trust included bookkeeping, financial account reconciliation and review, and preparation of unaudited financial statements. In this regard, Wilmington Trust regularly reviewed information regarding the SPI Entities' bank accounts. The Complaint alleges that Jackson provided monthly financial statements for the relevant accounts via an online data link run through J. Mading. [12] The Complaint also avers that Jackson's position as the intermediary between Wilmington Trust and Bank of America, Wells Fargo, and Wachovia—the banks housing the SPI Entities' financial accounts—was critical to his fraudulent scheme. [13]

In November 2007, SPIC–DC engaged Johnson Lambert to prepare audited financial statements for the calendar year ending December 31, 2007 (the "2007 Audited Financial Statements"). [14] On December 31, 2007, the DDOI approved the SPI Entities' application for a certificate of authorization, contingent on satisfactory receipt of the 2007 Audited Financial Statements, and Security Pacific, SPI–202, SPI–203, and SPI–204 were incorporated in Delaware as special purpose captive insurance companies.

2. The 2007 Audited Financial Statements are prepared and approved amidst irregularities

The allegations relating to the 2007 Audited Financial Statements span 120 paragraphs and over 40 pages of the Complaint. They describe in remarkable detail a process in which Wilmington Trust and Johnson Lambert, from February to December 2008, struggled to obtain the necessary confirmations to complete the audit. In the interests of brevity and clarity, I recount the well-pled facts relating only to the most significant areas of irregularity in this process. The first such area involved confirming the cash surrender value of a "key man" life insurance policy issued by Hartford Life and Annuity Insurance Company ("Hartford Life") in December 2005, which insured the life of Jackson for a face value amount of about $23.5 million (the "Key Man Policy"). [15] That policy was owned by SPIC–DC, and its purported cash value comprised the bulk of the assets Security Pacific claimed in its application to the DDOI. The 2005 and 2006 audited financial statements of SPIC–DC, prepared by Johnson Lambert, certified that the Key Man Policy had a cash value of $628,783 as of December 31, 2006. As discussed below, the audited financial statements for 2007, 2008, and 2009 continued to "confirm" the policy's cash value. In reality, the policy had lapsed in May 2006 and was worthless.

A second area in which Wilmington Trust and Johnson Lambert encountered difficulty in producing audited financial statements for the SPI Entities was confirming the cash and cash equivalents held in the several accounts they maintained at Bank of America, Wachovia Bank, Wachovia Securities, and Wells Fargo. As with the Key Man Policy, Johnson Lambert had confirmed the balances in these accounts in connection with the 2005 and 2006 audits of SPIC–DC. [16] By the time the Receiver took control of the SPI Entities in 2011, however, several of the bank accounts were basically empty, even though the 2007, 2008, and 2009 audits had "confirmed" that they had held several million dollars in the aggregate in those years.

a. The Key Man Policy

The interactions between Jackson, Wilmington Trust, and Johnson Lambert in connection with the confirmation of the Key Man Policy exemplify the larger pattern of delay tactics, deception, and otherwise questionable conduct that the Receiver ascribes to Jackson. In February 2008, Johnson Lambert asked Allan Drost of Wilmington Trust to obtain from Jackson a full, signed copy of the Key Man Policy. Drost emailed Jackson, who responded that he would assemble the necessary documents later that same day. Several months passed, however, without any follow-up from Jackson. [17] In early June 2008, Drost sent a series of confirmation forms to Jackson for him to sign and submit to Johnson Lambert. Around the same time, Drost advised Thomas Bolton of Johnson Lambert that Wilmington Trust intended to send a letter to the DDOI, advising it that the SPI Entities' audited financials were delayed, but would be provided by the end of July. Bolton agreed that that timeframe was not a problem. [18]

***5** On July 23, 2008, Justine Holeman of Johnson Lambert received a letter from Hartford Life informing Johnson Lambert that, because the confirmation inquiry they had submitted to Hartford Life was not signed by Jackson, they had forwarded the requested information to Jackson rather than to Johnson Lambert directly. [19] On the same day, Hartford Life sent Jackson a letter informing him that the Key Man Policy lapsed on May 21, 2006, and "does not have any value or coverage at this time." [20] A week later, Colleen Handy of Johnson Lambert emailed Jackson to ask if there was "any resolution" on the Key Man Policy confirmation and request that "someone from your office forward it on to us," because Hartford Life told Johnson Lambert that they sent it to Jackson. [21]

The Receiver alleges that Johnson Lambert knew, or should have known, that it was a breach of its internal policies and generally accepted auditing standards for it to seek the requested confirmation from Jackson, instead of directly from Hartford Life. [22] In any event, ten weeks went by without Jackson providing Johnson Lambert any confirmation regarding the Key Man Policy. Handy again emailed Jackson on September 29, 2008. He still did not respond. [23]

Unbeknownst to Handy, that same day Jackson faxed another confirmation request to Hartford Life. By letter dated October 10, 2008, Hartford Life responded, again informing Jackson that the Key Man Policy was no longer active. The Receiver alleges that this second request from Jackson was a ruse, and that he sent it simply to obtain the name and title of a different Hartford Life employee, which he got in the October 10 letter. [24] According to the Complaint, Jackson used this information to alter the original confirmation inquiry form Johnson Lambert had sent to Hartford Life in July 2008.

On October 24, 2008, nearly eight months after her initial request, Handy of Johnson Lambert reported to Drost of Wilmington Trust that she had received confirmation that the Key Man Policy was current and held a cash value of $716,000 as of December 31, 2007. [25] This confirmation was a forgery, allegedly sent via facsimile to Handy from Jackson, who had disguised the transmission as having come from Hartford Life. The faxed confirmation form stated that the original would be mailed, but no original ever arrived. Yet, Johnson Lambert never inquired further. [26]

b. The bank account confirmations

The alleged irregularities surrounding the SPI Entities' bank account confirmations are even more suspicious than the long-delayed and apparently forged Key Man Policy confirmation. The bank confirmation process unfolded during the same time period as that regarding the Key Man Policy, starting in June 2008. As with the Key Man Policy, Jackson delayed or failed to respond to the initial requests from

Wilmington Trust. In mid-July, Jackson signed request forms that Handy sent to the banks, with the instruction that the banks should confirm the relevant account balances and return the original confirmation requests, or "confirms" as they were called, by mail directly to Johnson Lambert. [27]

Six bank account confirms evidently were needed to prepare the 2007 Audited Financial Statements. In late July and August 2008, as Handy at Johnson Lambert was receiving the account confirms from the banks, she was having difficulty matching them up with the account statements that Jackson had given to Wilmington Trust. [28] In addition, one of the larger accounts, a Wachovia Securities money market account, could not be confirmed because, according to Wachovia, Jackson had not paid the nominal confirmation processing fee. [29] As August drew to a close, Drost emailed Jackson a list of issues that were preventing Johnson Lambert from completing its audit. The issues included that: (1) Johnson Lambert needed to contact Jackson's person at Wachovia to expedite the confirms on several of the banking accounts; (2) a Wachovia Securities account confirm showed a balance that was $300,000 less than the corresponding bank statement Jackson provided; (3) the confirm for a Wells Fargo money market account owned by SPI–203 reflected a balance of only $104, while the corresponding statement submitted by Jackson showed a balance of $2,361,706; (4) another Wells Fargo account was apparently closed, while Jackson's statement showed it open and holding a $10,000 balance; and (5) there were discrepancies with three Bank of America confirms, but the bank would not discuss them with Johnson Lambert. [30] One would think that item (3), at least, screamed for attention.

***6** Patrick Theriault of Wilmington Trust emailed Jackson, saying that these issues were "puzzling to say the least," and that the "significant variances ... do not appear to make sense." [31] On September 4, Handy emailed Drost of Wilmington Trust to say that she still had not received a signed request form from Jackson. Although Jackson told her that he tried to send it, but it "got bounced back to him," Handy considered that odd because Jackson had emailed her that day, and he "does have the right email address." [32] Around the same time period, Drost and Theriault told Jackson that these "logistical difficulties" could be avoided if Wilmington Trust had direct access to the bank accounts. Jackson allegedly ignored the request, and never took steps to give Wilmington Trust such access. [33]

As the process dragged on, the Wells Fargo, Wachovia Bank, and Wachovia Securities accounts proved the most difficult for Johnson Lambert to confirm and reconcile. In September 2008, Jackson instructed Wilmington Trust and Johnson Lambert that, instead of going through the audit departments at the banks, they should speak directly with Jackson's contacts—Joe Lobe or his assistant Pamela Goyette at Wells Fargo, and "Alpesh" or his assistant "Rachel" at Wachovia. [34] The Receiver avers that an Alpesh Patel was employed during this time by Wachovia Securities, but that the "Alpesh" and "Rachel" to whom Jackson referred were in fact "accomplices of [Jackson], if they existed at all." [35] Jackson apparently never provided the last name of "Alpesh." Moreover, the Complaint alleges that "a simple internet search" at that time would have revealed that the phone number Jackson provided for "Alpesh" was not a Wachovia number. [36] Instead, it appears that Jackson's own J. Mading used that phone number. Indeed, J. Mading had included it on its website and in other publications. [37]

On September 29, 2008, Handy notified Drost that the Wells Fargo and Wachovia account confirms were "rec'd and tied," without any further explanation. The Wachovia confirms allegedly were provided by "Rachel," the purported assistant of "Alpesh." [38] A day later, Handy told Drost and Theriault that she had attempted unsuccessfully to call "Alpesh" and Lobe multiple times. In response, Drost asked whether "the Wachovia contact [was] a different person for the Wachovia Securities confirm, or is this a contact for the regular retail banking accounts?" He also indicated that they should be "curious" about the Wells Fargo and Wachovia Securities confirmations, because of their "sudden resolution." [39] When Handy confirmed that "Alpesh" was the contact Jackson had given for both Wachovia Bank and Wachovia Securities, Drost observed that, "This is a little odd as Wachovia Securities is on the Trust side of the Wachovia structure," and that in his experience, "Most banks ... have definitive separation ... between their retail banking side of the business and the trust (investment) side." [40] Drost concluded that it "maybe, and hopefully is, OK," but that he would "try to contact both of them as well, to confirm if there was any specific reasons why suddenly now they are able to satisfy all the confirmations." [41]

Nearly a month later, as of late October, Handy still had not heard from either "Alpesh" or Lobe despite having left messages and asked Jackson several times to instruct them to call her, or to set up a conference call for all of them. The discrepancies between the statements provided by Jackson and the confirms received from Wachovia—which allegedly had exceeded $2,000,000—were the only things preventing the 2007 Audited Financial Statements from being completed. Through an email to Jackson, Drost joined in Handy's pleas. Their efforts persisted through November and most of December.

***7** It was not until December 29, 2008, however, that Bolton of Johnson Lambert received a call from a person identifying himself as "Alpesh." The caller explained that the bank confirmation discrepancies purportedly appeared because "they sold ars [sic] securities before year end that took a while to clear." [42] Bolton attempted to verify this information with Drost, but Drost could not find any trades that might fit Alpesh's description. In a communication to Drost, Bolton stated that he thought "maybe they were sold from another account [and] then deposited into this one? At any rate does this make sense to you? He caught me at a bad time and the reception was not good, so it was hard to hear him." [43]

Drost, admitting that he was "being optimistic," thought that the explanation given by "Alpesh" potentially could be chalked up to internal errors at the bank, and the lengthy delays and inconsistencies to the bank wanting to "save face." In any event, based on the new documents provided by "Rachel" and "Alpesh," Drost considered the bank confirmation to have been completed satisfactorily. According to the Receiver, in preparing the final 2007 Audited Financial Statement, Johnson Lambert used the fraudulent bank account balances from the documents that Jackson provided and "Alpesh" confirmed, rather than the different and significantly lesser amounts reflected in the written confirmations that it obtained directly from the banks. [44] As a result, the 2007 Audited Financial Statement, which was completed at the end of December 2008, reported that SPIC–DC held about $7.1 million in assets as of December 31, 2007.

c. The SPI Entities' Boards approve the 2007 Audited Financial Statements

Special meetings of the boards of directors of Security Pacific, SPI–202, SPI–203, and SPI–204 were held at the Delaware offices of Wilmington Trust on February 3, 2009 (the "February 2009 Meetings"). The boards of the SPI Entities were identical; they consisted of Jackson, James L. Jackson, King, Davis, and Kantner. Drost and Theriault allegedly attended the February 2009 Meetings in person or by teleconference, and one of them served as secretary and recorded the meeting minutes.

Notably, the audited financials were accompanied by a letter addressed to the SPI Entities' boards from Johnson Lambert (the "Significant Matters Letter"). [45] The Letter discussed the significant delay in completing the audit, and noted that six of the seven bank account confirmations diverged from the relevant account statements by "significant amounts ($2,361,602 in one case)" and that several follow-up inquiries were needed to resolve the discrepancies. [46] Johnson Lambert also addressed a letter to Jackson, as President and Chairman of Security Pacific, outlining several recommendations for improving operations (the "Jackson Letter"). The Jackson Letter, which was provided to the entire Board, indicated that the identified issues were "not considered to be material weaknesses." [47] The minutes allegedly indicate that the directors reviewed the 2007 Audited Financial Statements and approved them with "no substantive discussions or debate." [48]

3. The 2008 Audited Financial Statements are prepared and approved

Wilmington Trust's MSA automatically renewed at the end of 2008, and it therefore remained the captive manager for the SPI Entities. Johnson Lambert again was retained to serve as the SPI Entities' certified public accountant and independent auditor for the preparation of the audited financial statements for the calendar year ending December 31, 2008 (the "2008 Audited Financial Statement"). [49] Wilmington Trust and Johnson Lambert began the process of preparing that statement early in 2009.

***8** The Receiver's allegations with respect to the 2008 Audited Financial Statement are substantially similar to those relating to the 2007 Audited Financial Statement. In particular, the Complaint alleges that Jackson engaged in delay tactics and obfuscation in his dealings with Wilmington Trust and Johnson Lambert. [50] On June 23, 2009, Jackson allegedly delivered to Johnson Lambert another fraudulent confirmation for the Key Man Policy, after he had corresponded again with Hartford Life and received a second indication that the Key Man Policy lapsed in October 2006 and was worthless.[51] After receiving the fraudulent facsimile confirmation of the Key Man Policy from Jackson, Johnson Lambert never obtained the original or otherwise followed up with Hartford Life.

Also in June of 2009, Wilmington Trust and Johnson Lambert received allegedly fraudulent bank account confirmations from Jackson or his accomplice "Alpesh." Using that information, Johnson Lambert completed the 2008 Audited Financial Statement. As of September 2009, however, Johnson Lambert allegedly still was waiting for bank statements and other items from Jackson so that it could perform the confirmations needed for the "subsequent events" aspect of the audit.[52]

The boards of the SPI Entities held their annual meetings on October 8, 2009, at Wilmington Trust's Delaware office (the "October 2009 Meetings"). As of that date, the composition of the boards had changed. The directors for each of the SPI Entities in October 2009 consisted of Jackson, Muñoz, King, Davis, and Kantner. Drost and Theriault also attended the October 2009 Meetings.[53] At those meetings, the boards approved the 2008 Audited Financial Statement, again with little or no discussion.

Notably, there is no indication that Johnson Lambert ever followed up on the Significant Matters Letter or the Jackson Letter. As discussed above, those letters were provided to the Board in connection with the previous audit. They recommended that the SPI Entities change their procedures to conduct bank reconciliations on a monthly basis, and confirm accounts with the banks on a quarterly basis, in light of the "numerous differences" experienced in the 2007 Audited Financial Statements.[54] In a similar vein, Wilmington Trust had requested during the preparation of the 2007 Audited Financial Statements to have direct access to the bank accounts. The Complaint suggests that none of those recommended changes were made in the months between the February 2009 Meetings and the October 2009 Meetings. Indeed, it appears that neither Johnson Lambert, nor Wilmington Trust, nor any of the SPI Entities' directors inquired at the October 2009 Meetings as to the status of either of those previously reported deficiencies or suggested procedural improvements.[55] In any event, the recommended changes were never made.

4. The 2009 Audited Financial Statements are prepared and approved

At the October 2009 Meetings, Jackson notified the SPI Entities' boards that he did not intend to re-engage Johnson Lambert for the companies' next audit. Wilmington Trust's contract automatically renewed and in its continuing role as the captive manager, it assisted in seeking a new accounting and audit firm. Pursuant to an agreement dated April 23, 2010, McSoley McCoy was engaged to perform the SPI Entities' audit for the year ending December 31, 2009 (the "2009 Audited Financial Statement").[56]

***9** In May 2010, Drost forwarded to Nicholae Lungu of McSoley McCoy the bank and Key Man Policy confirmations used in connection with the prior year's audit. In his email to Lungu, Drost explained that, "In previous years, all of the Wachovia and Wachovia Securities confirmations were additionally faxed to a representative there named Alpesh, since he was able to make sure these were responded to right away, and avoided the new $25 audit confirmation response fee that they were initiating."[57] Drost copied Jackson on the email and asked him to "please confirm this person's full name, and his contact information," saying that he only had a phone number for Alpesh's assistant, and was not having "any success getting through, or even getting an opportunity to leave a message."[58]

About two months later, either Jackson or "Alpesh" complied with Drost's request for bank confirmations. The documents provided, however, were fraudulent confirmations as to the bank accounts, and yet another forged Key Man Policy confirmation, which showed the Policy as still effective and having a $700,000 cash value.[59] Like Johnson Lambert, McSoley McCoy never obtained the original policy from Hartford Life or otherwise communicated directly with them regarding the Key Man Policy.

McSoley McCoy completed the 2009 Audited Financial Statements at the end of July 2010. As with the 2007 and 2008 Audited Financial Statements, this one "confirmed" that the SPI Entities' total capitalization was around $7 million. The SPI Entities' boards again met at Wilmington Trust on December 15, 2010 (the "2010 Meetings"). By the time of that meeting, only Jackson, Davis, and Kantner remained as directors of the boards of Security Pacific, SPI–202, SPI–203, and SPI–204.[60] The Complaint does not address when, how, or why Muñoz and King left the boards or the reasons for the director turnover between the February 2009 and October 2009 Meetings. As with the previous two meetings, Drost and Theriault attended the 2010 Meetings on behalf of Wilmington Trust. At those Meetings, the boards approved the 2009 Audited Financial Statement with "no substantive discussions or debates." [61]

5. Wilmington Trust finally blows the whistle

In March 2011, for reasons not alleged in the Complaint, Wilmington Trust decided to inform the DDOI that it had noted certain irregularities or discrepancies involving Wachovia bank statements provided by Jackson on behalf of the SPI Entities. On March 15, 2011, Richard Klumpp, President and CEO of Wilmington Trust, sent an email to the DDOI in which he listed several of the SPI Entities' Wachovia accounts and compared the balances as reported in their recent statement to the Department (based on figures they had received from Jackson) to those reflected in confirmations they had received directly from Wachovia. [62] Jackson's figures portrayed the six accounts as holding values ranging from $25,000 to $1.7 million, and totaling $4.6 million in the aggregate. In reality, those accounts held a few hundred dollars each, except for one account, which seemed to be closed. [63]

On March 25, 2011, the DDOI sought and obtained from this Court a "Confidential Seizure and Injunction Order" pursuant to 18 *Del. C.* § 5943. The Department undertook further investigation, and ultimately obtained the Liquidation Order on June 15, 2011. In her capacity as Receiver of the SPI Entities in liquidation, the Commissioner investigated their financial condition. She concluded that "the assets of each of these entities is minimal when compared to the assets that were reflected in the entities' audited financial statements and fraudulent bank statements" that were provided by Jackson. [64] The Receiver's Complaint focuses on certain fraudulent bank statements Jackson gave to Wilmington Trust around July 2009, but also specifically alleges that Jackson's deception "both pre-existed and post-dated July of 2009." [65]

C. Procedural History

***10** As noted above, the Liquidation Action commenced on March 25, 2011. The Receiver filed this action on January 31, 2014, on behalf of the SPI Entities in liquidation. Counts 1 through 3 of the Complaint, respectively, accuse Wilmington Trust of breach of fiduciary duties, breach of contract, and negligence. The same basic charges are leveled against Johnson Lambert (Counts 4–7) and McSoley McCoy (Counts 8–10). [66] Count 11 includes a claim for breach of fiduciary duties against directors Jackson, Davis, King, and Kantner, and against Wilmington Trust. Finally, Count 12 charges Wilmington Trust, Johnson Lambert, McSoley McCoy, and Kantner with aiding and abetting the directors' alleged breaches of fiduciary duty.

James L. Jackson, Muñoz, and Ryan Building Group also were named as defendants in relation to the claim in Count 11 for breach of fiduciary duties against the SPI Entities' directors. As noted above, Ryan Building Group was dismissed voluntarily. James L. Jackson and Muñoz sought dismissal of the Complaint as it related to them under Court of Chancery Rule 12(b)(6). On August 12, 2014, I granted that motion. [67]

Currently before me are motions to dismiss filed by Wilmington Trust and Kantner, Johnson Lambert, and McSoley McCoy. Wilmington Trust and Kantner's motion was fully briefed and argued September 9, 2014. Because those two Defendants joined in several of the arguments raised by Johnson Lambert and McSoley McCoy in support of their motions, I reserved judgment and determined to decide all three motions together. The separate motions filed by Johnson Lambert and McSoley McCoy were argued November 20, 2014. [68] This Opinion resolves all three of these motions.

D. Parties' Contentions

In seeking dismissal, Wilmington Trust, Kantner, Johnson Lambert, and McSoley McCoy raise a slew of arguments that overlap to a significant degree. All of the Moving Defendants assert that the Complaint should be dismissed on grounds of *in pari delicto.* They also join in arguing that the claims at issue are time-barred.

Putting aside those common arguments, each Moving Defendant also seeks dismissal of the various counts in the Complaint against them for failure to state claims upon which relief could be granted. Johnson Lambert asserts that the breach of fiduciary duty, negligence, and aiding and abetting claims against it are barred because, among other reasons, they are precluded by the contractual relationship it has with the SPI Entities. Johnson Lambert challenges the claim for breach of contract for failure to allege causation. McSoley McCoy makes similar arguments.

***11** Wilmington Trust similarly contends that the Receiver cannot recover on her fiduciary duty and negligence theories because those allegations sound in breach of contract. It also asserts that the contract claim is defective, because it seeks to impose duties that go beyond the terms of the MSA. Wilmington Trust further argues that the aiding and abetting claim must be dismissed for lack of requisite "knowing participation." Kantner seeks dismissal of the indirect aiding and abetting claim against him on grounds that any conduct of his as a director of an SPI Entity that would rise to the level of aiding and abetting would, in itself, be a direct breach of fiduciary duty. Kantner also contends that the claim for breach of fiduciary duty against him should be dismissed for failure to state a claim.

II. ANALYSIS

A. Choice of Law

As a threshold matter, I conclude that Delaware law governs my analysis of the pending motions to dismiss. None of the parties strongly contends otherwise, [69] but Johnson Lambert suggests that the applicable law arguably could be that of Delaware, South Carolina (the location of Johnson Lambert's audit team), California (Jackson's principal place of business), or the District of Columbia (the place of incorporation of the SPI Entities' predecessors). [70] The Receiver seems to argue that Delaware law should apply in this situation, but she hedges by suggesting that material issues of fact may exist as to the correct choice of law. [71]

The causes of action here include claims sounding in breach of fiduciary duty, breach of contract, and tort, which are subject to different considerations for purposes of determining what law applies. Although the parties did not squarely address the question of choice of law, I consider it necessary to decide that issue, because whether and how I apply the doctrines of *in pari delicto* and laches might differ depending on which state's law governs. [72] Delaware law applies, however, at a minimum, to the claims for breach of fiduciary duties, because the SPI Entities are Delaware corporations. [73] Thus, each of the Moving Defendants is defending against at least one claim that will be governed by Delaware law. [74]

The internal affairs doctrine, however, does not extend to claims "where the rights of third parties external to the corporation are at issue." [75] Hence, the claims for breach of contract and negligence against Wilmington Trust and the Auditor Defendants are subject to the "most significant relationship test" of the Restatement (Second) of Conflicts of Laws. [76] For torts, the relevant factors of that test are: "(a) the place where the injury occurred, (b) the place where the conduct causing the injury occurred, (c) the domicil, residence, nationality, place of incorporation and place of business of the parties, and (d) the place where the relationship, if any, between the parties is centered." [77] For breach of contract claims, the factors differ slightly. They are: "(a) the place of contracting, (b) the place of negotiation of the contract, (c) the place of performance, (d) the location of the subject matter of the contract, and (e) the domicil, residence, nationality, place of incorporation and place of business of the parties." [78] Under both the tort and contract analyses, the relevant factors are to be evaluated according to their relative importance with respect to the particular issue involved. [79]

***12** Having considered the relevant factors of the test applicable in both the contract and tort contexts, I conclude that Delaware law should apply to all of the claims in this action. Admittedly, several alleged facts slightly favor other states. Those facts include that: Jackson allegedly lived and operated his business in California during the relevant time period; [80] the SPI Entities' predecessors were incorporated in the District of Columbia; [81] Theriault and Drost worked out of Wilmington Trust's office in Burlington, Vermont; [82] several of the relevant Johnson Lambert actors, including Bolton and Handy, worked in the firm's South Carolina offices; [83] and McSoley McCoy evidently also is based in Vermont. [84] It is not clear from the Complaint precisely where the accounting and auditing services actually were performed by Johnson Lambert and McSoley McCoy. At this relatively early stage, I consider it reasonable to infer, however, that it occurred in other states. Likewise, it fairly may be inferred that Theriault and Drost performed much of their captive services management work for Wilmington Trust in Vermont.

In contrast, many of the pertinent factors identified in the Restatement weigh in favor of Delaware, and I find that their cumulative effect eclipses that of factors that weigh in favor of applying California, D.C., South Carolina, or Vermont law. Regarding the negligence claims, I consider the alleged injury to have occurred in Delaware, where certain Defendants are alleged to have fraudulently inflated the SPI Entities' financial situation in order to deceive, primarily, the DDOI. As relevant to both the tort and contract analyses, while some of the Defendants may be incorporated in or reside elsewhere, all of the SPI Entities, whose legal and equitable claims the Receiver asserts in liquidation here, are Delaware corporations. Perhaps most persuasively, each of the three meetings of the SPI Entities' boards, upon which the Complaint's narrative of Defendants' alleged wrongdoing focuses, took place at Wilmington Trust's office in Delaware. Thus, of the states discussed by the parties, Delaware has the strongest claim to being "the place where the relationship, if any, between the parties is centered."

The subject matter of the relevant contracts, *i.e.,* the provision of audit or management services to Delaware-domiciled captive insurance companies, supports the same conclusion. Consequently, without even delving into the myriad issues related to the nature of captive insurance as a highly regulated industry under Delaware law, or the fact that the Insurance Commissioner has brought this action pursuant to her statutory authority as the receiver of these companies in liquidation, I conclude that Delaware law should govern not only the claims that implicate the internal affairs doctrine, but also the breach of contract and negligence claims as well. It is also true, however, that, "[i]n applying Delaware law, [this Court may] look, as courts often do, to well-reasoned precedent from federal courts, courts of our sister states, and our Anglo–American jurisprudential tradition." [85] Accordingly, I will not hesitate to do so.

B. Standard of Review

A motion to dismiss under Rule 12(b)(6) must be denied "unless the plaintiff could not recover under any reasonably conceivable set of circumstances susceptible to proof." [86] In determining whether the Complaint meets this pleading standard, this Court will draw all reasonable inferences in favor of Plaintiffs and "accept all well-pleaded factual allegations in the Complaint as true." [87] The Court, however, need not "accept conclusory allegations unsupported by specific facts or ... draw unreasonable inferences in favor of the non-moving party." [88]

C. Laches Does Not Bar These Claims

***13** All of the Moving Defendants contend that the Complaint is untimely. [89] They focus on the three-year statute of limitations applicable to the claims for breach of contract, negligence, and breach of fiduciary duty, and argue that each of the causes of action accrued more than three years before the Receiver filed her Complaint on January 31, 2014. [90] The Receiver does not contest that proposition, but contends that the statute of limitations either should not apply because it would lead to an inequitable result, or did not begin to run until March 25, 2011, when she was appointed as Receiver. [91] Because I agree with the first of those arguments, I do not address the second.

To determine whether an action was timely filed, this Court adheres to the doctrine of laches, the "equitable analog of the statute of limitations defense." [92] While the statute of limitations is not controlling in this Court, a suit in equity generally "will not be stayed for laches before, and will be stayed after, the time fixed by the analogous statute of limitations at law." [93] Nevertheless, in cases where "unusual conditions or extraordinary circumstances make it inequitable to allow the prosecution of a suit after a briefer, or to forbid its maintenance after a longer period than that fixed by the statute," this Court has the power to set aside the statutory limitation period and analyze whether the claim was untimely based on laches principles. [94] The Court must consider all the relevant facts in this regard, as there is no specific definition of "unusual or extraordinary circumstances." [95]

Based on the circumstances of this case, I am not inclined to mechanically apply the three-year statute of limitations under the laches rubric. Rather, I must analyze the timeliness of the Complaint based on the principles of laches more generally. To begin with, while this action was not filed until January 2014, the Receiver has been "pursuing" these claims at least since March 2011, when the Liquidation Action was commenced and the SPI Entities were placed into receivership. Notably, in effectuating service of process of the papers in the Liquidation Action on the SPI Entities, the Commissioner served Wilmington Trust as their registered agent. [96]

Further, from its inception until early 2014, the Liquidation Action involved fairly extensive litigation activity, including, for example: (1) contested motions concerning whether and how the Receiver could pay the ongoing administrative and legal expenses of the SPI Entities; [97] (2) periodic reports as to the financial status of the SPI Entities, some of which were objected to; [98] (3) a petition for the Court to set a bar date for claims against the SPI Entities; [99] and (4) numerous motions and hearings relating to former Defendant Ryan Building Group's claim regarding SPI–202, which ultimately resulted in a settlement shortly before the trial of that claim. [100] Unlike a situation in which a plaintiff is injured and then merely waits for years to file her action, the circumstances of this case arguably required the Receiver first to achieve certain successes in the Liquidation Action before completing her efforts to gather and marshal the facts necessary to plead non-conclusory allegations on behalf of the SPI Entities. Much of the Receiver's activity in that regard was occasioned by the positions taken by certain parties to this action, most notably Ryan Building Group.

***14** Meanwhile, the Receiver engaged in an extensive investigation to uncover the facts relating to the allegedly fraudulent conduct and related breaches of the Moving Defendants. As is evident from the face of the Complaint, the Receiver obtained and reviewed documents from at least some of the Moving Defendants, because the Complaint quotes extensively from emails and other communications that could not otherwise have been known. [101] This circumstance undermines any element of unfair surprise the Moving Defendants might claim with respect to the timeliness of this action. Indeed, taking into account all of the facts, I conclude that this case exhibits sufficiently "unusual or extraordinary" circumstances, based on the factors the Delaware Supreme Court has considered material in determining whether grounds exist for declining to apply the statutory limitation period. [102]

Instead, I find it more appropriate to consider whether laches would apply to bar these claims. A laches analysis calls for a context-specific application of the maxim that "equity aids the vigilant, not those who slumber on their rights." [103] While there is "no hard and fast rule as to what constitutes laches," establishing the elements of the defense generally requires: (1) knowledge by the claimant; (2) unreasonable delay in bringing the claim; and (3) resulting prejudice to the defendant. [104] The defense of laches is "not ordinarily well-suited" for treatment on a Rule 12(b)(6) motion." [105] Because there is neither unreasonable delay on the Receiver's part, nor prejudice to the Moving Defendants, I conclude that laches does not support dismissal of these claims.

An "unreasonable delay" for purposes of laches can range from one month to many years. [106] "The length of the delay is less important than the reasons for it." [107] In this case, there are two components of alleged delay. The first is from the time that the DDOI knew or was on inquiry notice that there might be a problem with the SPI Entities until the time the Receiver took action to prosecute these claims. The Moving Defendants contend that no later than the February 2009 Meetings, [108] the SPI Entities' directors—and, by extension, the Commissioner—were on notice as to the possibility of accounting irregularities based on the Significant Matters Letter. They conclude that because the DDOI was on inquiry notice as of early 2009 at the latest, the filing of the Complaint in January 2014 was unreasonably delayed.

I do not consider it appropriate or helpful, however, to look at the period from early 2009 to early 2014, as one undifferentiated time period. In reality, there are two distinct periods: (1) from the time the claims accrued in or around 2009 until the Commissioner placed the SPI Entities into receivership and began the process of stating claims on their behalf; and (2) from the establishment of the receivership until the filing of this action. The Moving Defendants' argument regarding inquiry notice relates to the former period, beginning in early 2009, and not the latter. In view of the allegations in the Complaint regarding fraud by Defendant Jackson and wrongdoing by the Moving Defendants in connection with the 2007, 2008, and 2009 Audited Financial Statements, I find that it is at least reasonably conceivable the Receiver will be able to show that neither she, as Insurance Commissioner, nor the DDOI engaged in any unreasonable delay before she was appointed Receiver in March 2011. [109]

***15** The second alleged period of delay is from the appointment of the Receiver in March 2011 until the filing of this action in January 2014. As just discussed, there was a substantial amount of litigation activity in the related Liquidation Action, and it is reasonable to infer at this preliminary stage that the Receiver's tardiness in filing this action was caused in large part by that activity. Moreover, as noted, when the Receiver took control of the SPI Entities in March of 2011, she had to begin unraveling a complicated web of facts as to how the SPI Entities ended up in the position they were in. It is reasonable to infer that investigation took a considerable amount of time because of its factual complexity rather than delay on the part of the Receiver. Based on these circumstances, the Receiver's good faith prosecution of the related Liquidation Action, the depth and complexity of this factual record, and the specificity and comprehensiveness of the Complaint she ultimately filed, I am not convinced that the Receiver's alleged delay, although significant, was unreasonable.

Additionally, the Moving Defendants suffered little or no prejudice due to the fact that the Receiver filed her Complaint in January 2014. As noted above, Wilmington Trust had actual notice from the very outset of the Liquidation Action that the SPI Entities were entering receivership and that any claims of theirs would be prosecuted by the Receiver. Based on the positions they occupied vis-à -vis the SPI Entities and the incomplete information they allegedly had regarding them, I consider it reasonable to infer that in or around March 2011 Wilmington Trust, Johnson Lambert, and McSoley McCoy all recognized the possibility of future claims against them as to those entities. As mentioned above, one or more of those Defendants probably participated in the Receiver's investigation by providing access to documents or other information in their possession, with which the Complaint is replete. I conclude, therefore, that the Moving Defendants could not reasonably have been unaware of the possibility of future claims against them arising out of their dealings with the SPI Entities, and thus were not materially prejudiced when the Receiver waited until January 2014 to file this action. For those reasons, I reject the Moving Defendants' argument that the Complaint should be dismissed as untimely, and proceed to consider other aspects of their motions to dismiss.

D. Claims for Breach of Fiduciary Duty [110]

Counts 1, 4, and 8 of the Complaint lodge claims for breach of fiduciary duty against, respectively, Wilmington Trust, Johnson Lambert, and McSoley McCoy. In Count 11, the Receiver also pleads breach of fiduciary duty as to the SPI Entities' directors, and she includes Kantner and Wilmington Trust in that category. [111] Wilmington Trust and the Auditor Defendants seek dismissal of these Counts, contending that they owed no fiduciary duties to the SPI Entities, and that the factual allegations in this regard are duplicative of the claims for breach of contract. Kantner has moved to dismiss Count 11 as it relates to him on grounds that the Complaint does not allege facts sufficient to give rise to a non-exculpated claim for breach of a fiduciary duty.

1. The claims against Wilmington Trust and the Auditor Defendants

As to Wilmington Trust and the Auditor Defendants, I conclude that the claims against them for breach of fiduciary duty must be dismissed. To state a claim for breach of a fiduciary duty, the factual allegations in a complaint must be such that they reasonably could support a finding that a fiduciary duty existed and the defendant breached that duty. [112] Neither Wilmington Trust nor the Auditor Defendants owed a fiduciary duty to the SPI Entities, however.

***16** The Receiver emphasizes that the SPI Entities trusted and relied on the Auditor Defendants' specialized experience in auditing generally and with captive insurance clients specifically. Without those services, the SPI Entities could not have functioned or been licensed in Delaware, and for that reason the Receiver asserts a fiduciary relationship existed between those entities and the Auditor Defendants. [113] Even accepting those allegations as true and drawing all reasonable inferences in favor of the Receiver, however, the Complaint fails to allege the existence of a fiduciary relationship under Delaware law. The core principle of a fiduciary duty is that "one who controls property of another may not, without implied or express agreement, intentionally use that property in a way that benefits the holder of the control to the detriment of the property or its beneficial owner." [114] The duties of care and loyalty flow from that "central aspect" of the fiduciary relationship. [115] Inherent in the fiduciary relationship, "which derives from the law of trusts," is that the fiduciary exercises control over the property of another, and by virtue of that control, is obliged to act with care and loyalty to interests of the beneficial owner. [116] In normal circumstances, an auditor's interests do not align perfectly with those of the client; in order properly to discharge its "watchdog" function, the auditor must "maintain total independence from the client at all times." [117]

Moreover, an auditor normally does not exercise any control over the affairs of the corporation. It is not surprising, therefore, that the Complaint is devoid of factual allegations suggesting that there was some extraordinary circumstance here that would have caused the Auditor Defendants to do so with respect to the SPI Entities. The mere provision of audit services does not of itself convert an auditor into a fiduciary of the corporation. "Our courts have been cautious when evaluating entreaties to expand the number and kinds of relationships that are denominated as 'fiduciary.' " [118] Consistent with that approach, I see no basis for finding that the Auditor Defendants had a fiduciary relationship with the SPI Entities, where the pillars of the fiduciary relationship —control over the property of another and alignment of the controller's interests with those of the beneficial owner— cannot reasonably be inferred from the well-pled allegations of the Complaint.

The situation is no different with Wilmington Trust, despite the Receiver's twofold contention otherwise. First, she argues that, as with the Auditor Defendants, because Wilmington Trust marketed itself to the SPI Entities as having special expertise in captive management, and the SPI Entities relied on the management services provided, a fiduciary relationship existed that included duties of care and loyalty. [119] The Complaint alleges that Wilmington Trust provided substantial administrative and ministerial assistance relating to the day-to-day operation of the SPI Entities, especially in terms of their compliance and regulatory obligations. Control of the SPI Entities, however, was in the hands of their officers and boards of directors, who were charged, for example, with causing the SPI Entities to contract with Wilmington Trust for the provision of captive management services, and with reviewing and approving the financial statements that were produced with the assistance of Wilmington Trust. Notwithstanding how fraudulently those managers allegedly acted, the SPI Entities were managed by sophisticated business persons. That factual reality negates the kind of control and interest-alignment between Wilmington Trust and the SPI Entities that our case law requires for the existence of a fiduciary relationship. Instead, the SPI Entities and Wilmington Trust had a contractual relationship, defined by the MSA.

***17** The Receiver's second argument as to Wilmington Trust —that it was a "*de facto* director" of the SPI Entities—is similarly unpersuasive. [120] The cases cited by the Receiver in which courts have applied that theory have involved claims under the federal securities and antitrust laws. She offered no support for the proposition that, under Delaware common law, this Court should consider a third-party business entity as a "*de facto* director" because its employee sat on the board of the client corporation. [121] The board of directors of a corporation organized under the Delaware General Corporation Law ("DGCL") "shall consist of 1 or more members, each of whom shall be a natural person." [122] In the absence of any case law or persuasive logic supporting the Receiver's position, I reject the notion that a corporate employer of an employee designated to serve as a director of another company could be deemed a *de facto* director of that other company.

2. The claims against Kantner

The only remaining Moving Defendant, Kantner, clearly owed fiduciary duties of care and loyalty to the SPI Entities, because he was a director of each of those entities during the relevant time period. [123] Kantner seeks dismissal of the breach of fiduciary duty claim in Count 11 as it relates to him on grounds of exculpation. He argues that each of the SPI Entities' charters contains an exculpation provision consistent with 8 *Del. C.* § 102(b)(7), and the Complaint fails to allege bad faith or any other form of unexculpated conduct on his part. Kantner further contends that, as a director, he was entitled to rely on the Auditor Defendants and Wilmington Trust, and is therefore protected from liability under Section 141(e). [124] Because neither of those contentions is conclusive at this preliminary stage, I deny Kantner's motion to dismiss Count 11.

The crux of the Complaint's allegations against Kantner relate to a claim for failure of oversight, on a *Caremark* theory of liability. [125] Directors can be liable on *Caremark* grounds for: (1) utterly failing to implement any reporting or information system or controls; or (2) consciously failing to monitor or oversee such a system, thereby disabling themselves from being informed of risks or problems requiring their attention. [126] In either situation, oversight liability requires "a showing that the directors knew that they were not discharging their fiduciary obligations," resulting in a breach of the duty of loyalty for failure to act in good faith. [127] Proving liability under the *Caremark* line of cases "is possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment." [128]

***18** The Complaint contains sufficient non-conclusory factual allegations for it to be reasonably conceivable that Kantner ultimately may be liable on this theory. Kantner's tenure as a director of the SPI Entities covered each of the

February 2009 Meetings, the October 2009 Meetings, and the 2010 Meetings, at which the entities' boards approved the audited financial statements with little or no substantive discussion, despite warnings that significant irregularities occurred and the companies' procedures needed to be changed. In terms of oversight, I note first that, based on the allegations in the Complaint regarding those events, I do not consider it reasonably conceivable that Kantner could be liable on grounds that he utterly failed to implement a monitoring or reporting system for the SPI Entities. The boards of the SPI Entities authorized the retention of Wilmington Trust and the Auditor Defendants to provide such a monitoring mechanism.

Whether I reasonably can infer from the Complaint that Kantner consciously disregarded a known duty to oversee that monitoring system depends on how I view the Significant Matters Letter, in which Johnson Lambert indicated to the boards that Johnson Lambert met with considerable difficulty in preparing the 2007 Audited Financial Statements, including several extraordinary balance discrepancies in the SPI Entities' accounts. The Receiver urges me to conclude that the Letter included "red flags" and that the directors' failure to follow up on those concerns reasonably could amount to a conscious disregard of their oversight responsibilities. Kantner, on the other hand, contends that, because the Significant Matters Letter implied that remedial actions had been taken and the Jackson Letter suggested that the problems were "not considered material," he and the other directors were justified in relying on the Auditor Defendants' representations and not inquiring further into the issues.

That argument might hold water as to some of the directors, but it reasonably could be inferred from the allegations in the Complaint that Kantner, as an employee of Wilmington Trust, actually knew or constructively knew more about the seriousness of the problems Wilmington Trust and the Auditor Defendants were having with Jackson. The Complaint is replete with allegations that Drost, Theriault, and others at Wilmington Trust had actual notice of the fact that something material was amiss with Jackson and his purported financial information. Their extensive dealings with the mysterious "Alpesh" are just one example of Wilmington Trust's awareness of Jackson's highly unorthodox business practices. The picture that emerges from the facts alleged is that Jackson's conduct did not pass the sniff test. Nevertheless, Wilmington Trust and the Auditor Defendants allegedly held their noses and looked the other way in order to get the audits finished, file the paperwork, collect their fees, and move on.

The Complaint further supports an inference that Drost, Theriault, or some other person at Wilmington Trust, consistent with Wilmington Trust's internal policies or common sense business practices, shared their misgivings with Kantner. The Complaint conceivably also could support the opposite inference—that that information never made its way to Kantner, because, for example, Drost and Theriault worked in Wilmington Trust's Vermont office, while he was in Delaware. I cannot say, however, that such a contrary inference is the only reasonable inference that could be supported by the Receiver's allegations. At the motion to dismiss stage, it would be improper to make that leap, as Kantner urges me to do. I therefore conclude that, regardless of whether the Significant Matters Letter and the Jackson Letter would have misled one or more directors into thinking that all was well at the SPI Entities, Kantner was positioned differently than the others by virtue of his position as Accounting Manager at Wilmington Trust and its designated director on the SPI Entities' boards. [129]

***19** The Complaint contains numerous allegations about Kantner's colleagues' repeated, and largely unsuccessful, attempts to get Jackson to provide information, or sign a form, or set up a call with the elusive "Alpesh," or provide direct access to the bank accounts. A reasonable inference can be drawn from the Complaint—and at this stage, I am required to draw such inferences—that Kantner was made aware of these problems through communications with Drost or Theriault, discussions made all the more likely because of Kantner's position as the statutorily required "resident director" on the SPI Entities' boards. Yet, Jackson apparently went about his fraudulent scheme year after year, while the Board unquestioningly approved the annual audited financial statements and failed to follow up on the suggested operating procedure improvements. Kantner allegedly went along without raising a peep. In their reliance on Jackson, Wilmington Trust, the Auditor Defendants, Kantner, and the other directors may have been overly supine. [130] Taking all allegations in the Complaint as true, however, Kantner's disengagement conceivably could amount to a conscious disregard of his duties based on what he reasonably may be assumed to have known about the SPI Entities' deficiencies. As a result, I consider it reasonably conceivable that Kantner knowingly disregarded his oversight responsibility, and thereby subjected himself to potential liability on a *Caremark* claim. Thus, I deny his motion to dismiss that aspect of the Complaint.

E. Claims for Breach of Contract, Negligence, and Aiding and Abetting

Unlike claims for a breach of fiduciary duty, claims for breach of contract, negligence, and aiding and abetting arguably may be subject to the defense of *in pari delicto.* In this section of the Opinion, I take up the Moving Defendants' contention that *in pari delicto* bars those claims as a matter of law. After reviewing the *in pari delicto* doctrine under Delaware law and concluding that it may provide a bar, I examine whether any of the exceptions to that doctrine could apply here and enable the relevant claims to go forward.

1. *In pari delicto*

a. Basics of the doctrine

In pari delicto is an affirmative defense by which " 'a party is barred from recovering damages if his losses are substantially caused by activities the law forbade him to engage in.' "[131] The doctrine provides that rather than adjudicating a suit by one wrongdoer against her counterpart, courts will " 'leave them where their own acts have placed them.' "[132] *In pari delicto* serves at least two important policy goals: deterring wrongful conduct by refusing wrongdoers any legal or equitable relief, and protecting the judicial system from having to use its resources to provide an accounting among wrongdoers.[133] Thus, courts have recognized that the rule " 'is adopted, not for the benefit of either party and not to punish either of them, but for the benefit of the public.' "[134] Like most American jurisdictions, Delaware embraces this venerable doctrine.[135]

Although the literal translation is "in equal fault," courts have eschewed a strict requirement that the party asserting the defense demonstrate that the degree of his fault is the same as or less than that of the party against whom he asserts it. The rule therefore has been held to apply "to situations more closely analogous to those encompassed by the 'unclean hands' doctrine, where the plaintiff has participated 'in some of the same sort of wrongdoing' as the defendant."[136] For that reason, *in pari delicto* may be raised against a plaintiff wrongdoer even if that plaintiff "was led into a path of crime by one more culpable."[137] Moreover, because the main purpose of *in pari delicto* would be undermined by fact intensive proceedings comparing the culpability of the wrongdoers, the defense may be raised successfully on a motion to dismiss, unless the complaint is devoid of grounds for invoking the rule.[138]

***20** As relevant here, *in pari delicto* applies to bar claims between wrongdoers regardless of whether the plaintiff wrongdoer is a natural person or a corporation. A basic tenet of corporate law, derived from principles of agency law, is that the knowledge and actions of the corporation's officers and directors, acting within the scope of their authority, are imputed to the corporation itself.[139] Delaware law adheres to this general rule of imputation—of holding a corporation liable for the acts and knowledge of its agents—even when the agent acts fraudulently or causes injury to third persons through illegal conduct.[140] Though at superficial level it may appear harsh to hold an "innocent" corporation (and, ultimately, its stockholders) to answer for the bad acts of its agents, such "corporate liability is essential to the continued tolerance of the corporate form, as any other result would lack integrity."[141] These considerations are central to the *in pari delicto* doctrine: the practice of imputing officers' and directors' knowledge to the corporation means that, as a general rule, when those actors engage in wrongdoing, the corporation itself is a wrongdoer.[142] As such, the company generally is barred from stating a legal or equitable claim against a third party that participated in the scheme of wrongdoing.

b. Exceptions to the rule

A principal, however, is not presumed to have knowledge of or be liable for the actions of an agent that abandons the principal's interests.[143] Likewise, corporations have not been held to the general rule of *in pari delicto*"when the corporate agent responsible for the wrongdoing was acting *solely to advance his own personal financial interest,* rather than that of the corporation itself."[144] This departure from the general rule of imputation, known as the "adverse interest exception," is one of three major ways that courts adhering to the traditional *in pari delicto* rule have avoided application of the doctrine in a specific context.

The adverse interest exception, if applied correctly, should cover only the "unusual" case in which the allegations support a reasonable inference of "the type of total abandonment of the corporation's interests" that is characteristic of, for example, outright stealing from the corporation. [145] Because most instances of fraud or illegal misconduct by corporate actors confer at least some benefit on the corporation, the adverse interest exception may not apply even when the "benefit" enjoyed by the corporation is outweighed by the long-term damage that is done when the agent's mischief comes to light. [146] Nevertheless, where agents act purely in pursuit of their own interest to the detriment of the principal to whom they owe fiduciary duties, the societal interest in deterring such action is strong enough that the policies underlying the *in pari delicto* doctrine give way and the acts and knowledge of the faithless agent are not imputed to the corporation.

Deciding when a countervailing public policy should trump the policies animating *in pari delicto* often proves difficult. The *in pari delicto* doctrine has manifest appeal in the classic case of, for example, a thief who is injured in commission of a crime; it would be absurd to allow him to sue a co-felon who stole the injured thief's share of the loot, or the burglarized homeowner whose negligent maintenance caused a slip-and-fall. [147] When the rule is invoked against a corporation attempting to sue a party that previously joined in or facilitated its wrongdoing, however, the policy rationale of the case can be less clear-cut. A prototypical instance involves "innocent" stockholders bringing suit derivatively on behalf of the corporation to recoup some of the losses caused by the fraudulent actions of its officers and directors, who may well have been removed from the company already. While equitable considerations may not come into play in the case of the plaintiff thief, they might in the case of the corporation-as-derivative-plaintiff—or, as relevant here, the receiver of entities driven to insolvency by faithless fiduciaries—because innocent stockholders or creditors may gain or lose depending on the way the doctrine is applied.

***21** That specific concern animates a second carve-out from *in pari delicto:* the fiduciary duty exception. Under that exception, perhaps the most expansive, the doctrine has no force in a suit by a corporation against its own fiduciaries. [148] Although various rationales have been advanced as supporting this exception, [149] the underlying justification is that parties like receivers, trustees, and stockholder derivative plaintiffs must be able to act on the corporation's behalf to hold faithless directors and officers accountable. "To hold otherwise would be to let fiduciaries immunize themselves through their own wrongful, disloyal acts," [150] a "transparently silly" result. [151] The fiduciary duty exception to the *in pari delicto* doctrine ensures that stockholders (and, in cases of insolvent entities, creditors) have a remedy for the wrongdoing that caused them harm. That consideration is paramount in a court of equity, such as this Court, which "will suffer no wrong without a remedy." [152] The existence of the fiduciary duty exception, therefore, re-frames the fundamental inquiry involved in deciding whether to apply *in pari delicto* or set it aside: the issue is "not whether stockholders can seek relief on the corporation's behalf, but from whom stockholders can seek that relief." [153]

A similar rationale underlies a third category of cases in which courts have avoided *in pari delicto,* even where by its terms it would apply: *i.e.,* the exception that applies "when another public policy is perceived to trump the policy basis for the doctrine itself." [154] Cases falling under this seemingly diffuse "public policy exception" are united by fact patterns involving statutory schemes like the federal securities laws that rely in significant part on private causes of action for their enforcement. [155] In such instances where the claim at issue directly furthers an established policy, courts may defer to that policy by setting *in pari delicto* aside and allowing the action to go forward.

c. *AIG I* and *AIG II*—the leading Delaware cases on *in pari delicto*

Because it is the central authority on which the parties rely for their statement of the *in pari delicto* doctrine in Delaware, and because it is perhaps easiest to envision the doctrine's application by way of example, I review briefly this Court's decisions in *In re American International Group, Inc. Consolidated Derivative Litigation.* [156] That action arose out of a wide-ranging array of financial misconduct by several high-level officers and directors of American International Group, Inc. ("AIG"). In particular, it was alleged that AIG's Chairman and CEO, Maurice R. Greenberg, and several of his top lieutenants orchestrated a series of transactions designed to inflate AIG's perceived financial strength, engaged in illegal schemes to avoid taxes, sold illegal financial products to other companies, and conspired with competitors to rig certain insurance markets. [157] When the various schemes were discovered, AIG had to restate years' worth of its financials, which ultimately resulted in a reduction of the stockholders' equity of $3.5 billion. Additionally, the company was forced to pay nearly $2 billion to resolve various criminal and civil proceedings lodged against it. [158]

***22** Certain stockholders, derivatively on AIG's behalf, brought a litany of claims against various defendants. [159] Greenberg, his inner circle of corporate officers, and multiple directors and employees of AIG were sued for, among other things, breaches of fiduciary duty. The derivative complaint also leveled claims for fraud, conspiracy, and aiding and abetting against General Re Corporation ("Gen Re"), with which AIG had engaged in several illegal transactions designed to misrepresent the strength of AIG's insurance reserves. [160] In connection with AIG's scheme to rig bids in an insurance brokerage market, the derivative complaint further included counts for fraud and conspiracy against Marsh & McLennan Companies, Inc. ("Marsh"), ACE Limited ("ACE"), and an ACE executive; Marsh additionally was sued for aiding and abetting a breach of fiduciary duty and for unjust enrichment. [161] Finally, the derivative plaintiffs sued PricewaterhouseCoopers LLP ("PwC"), AIG's independent auditor, for breach of contract and malpractice, on the theory that they wrongly had certified AIG's financial statements as accurate and GAAP-compliant, when they ultimately had to be restated by billions of dollars. [162]

In *AIG I,* Chief Justice Strine, then writing as Vice Chancellor, addressed motions to dismiss filed by the AIG defendants—Greenberg and his inner circle, and several former and current AIG employees—and PwC. [163] The Court dismissed the claims against the employee defendants on personal jurisdiction grounds, but largely refused to dismiss the claims against Greenberg and his top lieutenants. [164] Although it was not discussed in *AIG I,* a necessary predicate of that aspect of the opinion was the fact that, as corporate officers and directors who owed fiduciary duties to AIG and its stockholders, none of those defendants were able to invoke the *in pari delicto* defense. [165]

More pertinent to this Opinion, however, was the treatment in *AIG I* of PwC's motion to dismiss. In that regard, the complaint asserted that PwC committed malpractice and breached its contract with AIG by failing to discover widespread fraud that occurred at the upper levels of AIG management, and that AIG suffered greater losses than it would have if PwC's auditing had conformed to generally accepted auditing standards ("GAAS"). PwC invoked the defense of *in pari delicto,* arguing that AIG was a wrongdoer in that situation, and because the claim was AIG's—even if pursued derivatively on its behalf by various stockholders—the company was barred from stating a claim against a fellow wrongdoer under the law of New York, which PwC claimed governed. The choice of law issue was addressed first. Relying on the most significant relationship test, the Court agreed that New York law governed AIG's claims against PwC. [166]

After reviewing the applicable New York precedent relating to *in pari delicto,* the Court concluded that, if it were to apply the *in pari delicto* doctrine as the New York Court of Appeals likely would, AIG's derivative claims against PwC would be barred by the rule of imputation. It also determined that the narrow adverse interest exception could not be invoked because the complaint suggested that the alleged wrongdoing of Greenberg and other AIG officials had not been committed solely for the benefit of the insiders themselves. [167] AIG itself had benefitted from the financial machinations of the insiders' fraud, even if those benefits turned out to be short-lived once the misconduct came to light. [168] Thus, *in pari delicto* applied, and the claims against PwC were dismissed.

In reaching that decision, then-Vice Chancellor Strine expressed discomfort with the result of New York's rule, and two aspects of his *obiter dictum* comments in that regard are particularly relevant to this case. First, he indicated that, if PwC had been accused of aiding and abetting a breach of fiduciary duty, his choice of law determination might have been different. [169] Because of Delaware's "paramount" interest in policing alleged breaches of fiduciary duties within Delaware corporations, he posited that the gravity of a claim for aiding and abetting such a breach potentially could trump another state's interest in adjudicating issues of professional misconduct according to its own laws. [170] Second, then-Vice Chancellor Strine stated that, even as to AIG's breach of contract and malpractice claims against PwC, if Delaware law were applicable, he "would be chary about following the New York approach." [171] In so doing, he questioned some of the assumptions that appeared to underlie the rationale of New York's *in pari delicto* doctrine as it presumably would apply to corporate advisors like PwC.

***23** Two further aspects of the *AIG* litigation are noteworthy here. After this Court's decision in *AIG I,* the Delaware Supreme Court certified to the New York Court of Appeals (the "New York Court") the issue of whether, under New York law, the *in pari delicto* defense was effective to bar AIG's derivative claims against PwC. [172] In *Kirschner v. KPMG LLP,* the New York Court answered that question and a closely related one arising out of an action in the federal courts of the Second Circuit. [173] As to both questions, the Court upheld New York's strict *in pari delicto* rule by refusing to adopt a contrary position advocated by the stockholder derivative plaintiffs in *AIG I* and the analogous position of a litigation trustee in a bankruptcy action. In so ruling, the New York Court explicitly declined "to alter our precedent relating to in pari delicto, and imputation and the adverse interest exception, as we would have to do to bring about the expansion of third-party liability sought by plaintiffs here." [174]

Finally, in *AIG II,* the Court of Chancery addressed motions to dismiss brought by Gen Re, Marsh, and ACE. As discussed above, those defendants were subject to claims on behalf of AIG for fraud, conspiracy, and aiding and abetting breaches of fiduciary duty. Notably, in ruling on the motions to dismiss, then-Vice Chancellor Strine applied Delaware law. He concluded that Delaware's *in pari delicto* defense applied to bar AIG from stating claims against any of those three alleged co-conspirators. [175] In reaching that decision, the Court rejected two arguments that the derivative plaintiffs advanced to avoid the *in pari delicto* doctrine. First, as a factual matter, the Court ruled that the allegations in the complaint reasonably could support an inference that AIG was "in equal fault" with the co-conspirators as to the alleged fraudulent transactions. [176]

Second, the Court held that, as a matter of Delaware law, there was no policy justification for setting aside the *in pari delicto* doctrine to allow a corporation guilty of wrongdoing to sue its alleged co-conspirators. [177] In this regard, it found unpersuasive the derivative plaintiffs' argument that because the stockholders themselves had done nothing wrong, it would be unjust to prevent them from recouping some of their losses. The Court observed that accepting that line of reasoning "would eviscerate the in pari delicto doctrine and contravene the policy judgments upon which that doctrine rests." [178] The Court noted that the AIG stockholders already had the benefit of the major exception to the *in pari delicto* rule: the ability to sue corporate insiders, such as directors and officers whose actions precipitated the claimed losses, on behalf of the company. "The issue," it stated, "is therefore not whether stockholders can seek relief on the corporation's behalf, but from whom stockholders can seek that relief." [179] Allowing stockholders to expand this exception, however, by suing parties "outside of the borders of their corporation would not be socially useful." [180] The important policy considerations animating the *in pari delicto* doctrine—principally, sparing the court from wasting its resources to provide an accounting among wrongdoers—would be severely undermined by allowing the kind of claims brought by the derivative plaintiffs to go forward. As for the purported benefits of setting aside the rule, the Court observed that companies like Gen Re, Marsh, and ACE needed little added incentive to follow the law, based on "the potent public enforcement that exists as to many important laws that regulate" such businesses. [181]

2. The question presented here, and the relevant contentions

***24** In summary, Delaware law adheres to the doctrine of *in pari delicto,* and where it applies, the doctrine precludes the court from hearing claims as between wrongdoers unless the wrongdoer-plaintiff against whom it is invoked can avail herself of an exception to the rule. Guided by the foregoing principles, my analysis of this issue as it pertains to the present motions consists of asking: first, should *in pari delicto* apply to the Receiver's claims against Wilmington Trust and the Auditor Defendants? And if so, is there an exception that would save those claims from dismissal?

In this regard, the Moving Defendants contend that the doctrine applies here, because the alleged misconduct of the SPI Entities' fiduciaries—most clearly, Jackson—is imputed to the SPI Entities, making them at least substantially equal in fault to the Moving Defendants. They contend that even though the Receiver has brought this action on behalf of the SPI Entities and their stakeholders, she has only the rights of, and is subject to the same defenses as, the SPI Entities themselves. Finally, the Moving Defendants argue that no exception to the doctrine is available to prevent the dismissal of the SPI Entities' claims.

The Receiver challenges all three of those contentions. In particular, she asserts that the well-established adverse interest exception applies here. The Receiver also contends that *in pari delicto* should not apply because this case involves an insurance liquidation receivership action. Thus, for the public policy reasons embodied in Delaware's insurance statute and related regulations, she argues that this Court should decline to apply the general rule of imputation by which *in pari delicto* operates to bar claims. Finally, she maintains that, even if *in pari delicto* applies and the adverse interest exception is unavailable, Delaware law should not permit an auditor to invoke the doctrine, because of the special role auditors play in informing corporate fiduciaries. I discuss these issues in turn.

At the outset, however, I note that, by the Complaint's own terms, the SPI Entities bear "substantially equal responsibility" [182] for the alleged schemes by which money was stolen from the policyholders and the DDOI was misled about the SPI Entities' true financial condition. For example, the Complaint accuses James M. Jackson of fraud, and takes issue with the Moving Defendants' failure to detect and prevent that fraud. It is clear, however, that the relevant actions in this regard were taken on behalf of the SPI Entities, so that they could obtain the DDOI's approval to operate as captive insurers. [183] Thus, the general doctrine of *in pari delicto* applies to bar the SPI Entities' claims against the Moving Defendants, unless the Receiver can avail herself of some exception to that doctrine. [184]

3. Can the Receiver avail herself of the adverse interest exception to the *in pari delicto* doctrine?

The Receiver contends that, even if it applies, *in pari delicto* does not bar the claims against the Moving Defendants because she may take advantage of the "adverse interest exception." As discussed above, this exception is derived from the same body of agency law imputation principles that gave rise to the *in pari delicto* rule itself. [185] That is, in a case where the agent's action is totally adverse to the interests of his principal, the law will not impute knowledge of the bad act to the principal, because it seems nonsensical to presume that a thieving agent would tell his principal about the theft. [186] In the corporate context, and as relevant here, where a corporate fiduciary acts "solely to advance his own personal financial interest, rather than that of the corporation itself," the adverse interest exception comes into play and permits the corporation to state a claim against the faithless fiduciary's co-conspirator. [187] This type of total abandonment, such as siphoning corporate funds or other outright theft, is likely to be a "highly unusual case." [188] Thus, the adverse interest exception is applied narrowly, lest it be expanded to the point of covering more terrain than the rule itself. [189] As a result, the exception will not enable a party to avoid application of *in pari delicto* if the illegal scheme furthers both the faithless fiduciary's interests and those of the corporation itself. [190]

***25** On the facts of this case, the adverse interest exception is unlikely to save the Receiver's claims. The allegations in the Complaint conceivably could support a reasonable inference that at least Jackson was involved in siphoning money from the SPI Entities' bank accounts, which could be the sort of total adversity required to sustain the exception. Another equally plausible reading of the Complaint, however, is that there never was any money in the bank accounts during the relevant time periods, but rather that the entire structure was a sham. Because this action is before me on motions to dismiss, I must draw all reasonable inferences in favor of the Receiver. Accordingly, I assume that at some point during the relevant time period, at least Jackson stole funds from the SPI Entities' accounts.

While Jackson's alleged theft is indicative of an intent to act "to advance his own personal financial interest," the Complaint also suggests that his activities furthered the SPI Entities' interests. The Complaint is replete with allegations that, if not for the misrepresented financial statements, the SPI Entities never would have been authorized as Delaware-domiciled captive insurers. This may have been a temporary benefit, which proved illusory once the fraud came to light, but it is clear from the face of the Complaint that the SPI Entities' position was improved, if only for a time, by Jackson's machinations. [191]

Even if I were to assume that Jackson completely had abandoned the SPI Entities' interests and that those entities obtained no benefit from his conduct, however, the Receiver still cannot invoke the adverse interest exception in the circumstances of this case. The reason is because the SPI Entities are subject to an exception to the adverse interest exception—the "sole actor" exception. [192] Courts have applied the sole actor exception where the agent committing the fraud was the sole stockholder of the corporation, or otherwise "dominated" the corporation. [193]

As discussed above, the adverse interest exception is based on the presumption that a completely faithless agent would not communicate his knowledge to his principal, and that the principal would not benefit from the agent's adverse action. The sole actor rule overrides the adverse interest exception where the principal and the agent are the same, because it is absurd to presume that the one actor involved and affected somehow could keep secrets from himself, and because the principal, as the same sole owner, benefits from the fraud. [194] Thus, in the corporate context, where a high-level officer or director also solely owns or otherwise dominates the corporation, the principal-agent distinction virtually disappears. In terms of a claim against a third party that dealt with the corporation, therefore, the adverse interest exception will not aid an agent-principal who does wrong by protecting the corporation he controls from the effect of *in pari delicto.*

***26** In this case, Jackson was at all relevant times the President and Chairman of Security Pacific, SPI–202, SPI–203, and SPI–204, and held 100 percent of those companies' stock. [195] The Receiver does not dispute that Jackson solely owned and dominated the SPI Entities. Rather, she contends that the sole actor rule should not apply here because of the nature of the insurance business, in which policyholders and the public at large have a stake in the solvency of insurers. According to the Receiver, it therefore would be unjust for this Court to presume that there is a "complete unity of interest between a sole stockholder who loots his own insurance company and the company itself." [196] Taken to its extreme, this would mean that the existence of policyholders and other innocent creditors in the insurance context should cause the adverse interest exception to apply and avoid the *in pari delicto* doctrine, because the fraudulent corporate insider was acting adversely to the public's interests, even if not to those of the corporation's owners. [197]

That reasoning, if accepted, would mean that the *in pari delicto* defense cannot apply to any case in which the claims are being asserted by an insurance company, either in receivership or as a derivative plaintiff. I cannot square such a result with the decision in *AIG II,* which involved one of the most systemically important insurance companies in the world. [198] For that reason, I reject the Receiver's attempt to avoid application of the "sole actor" rule. [199] I therefore conclude that the adverse interest exception—even if it conceivably could apply, which is dubious based on the allegations of the Complaint—cannot be invoked here because of the sole actor rule.

4. Should *in pari delicto* be set aside on grounds that its application would frustrate an established public policy of this State?

***27** As discussed above, while courts generally will refuse to hear claims as between wrongdoers, "that rule has always been regarded by courts of equity as without controlling force in all cases in which public policy is considered as advanced by allowing either party to sue for relief against the transaction." [200] The Receiver's contention in this regard is twofold: (1) that receivers are not, or should not be, barred by the *in pari delicto* defense; and (2) that important public policy interests are served by the Receiver here, in the specific context of insurance liquidation. I do not find either contention persuasive.

I begin with the suggestion that because the Receiver is innocent of wrongdoing when she "steps into the shoes" of the liquidated entities, she cannot be subject to the defenses to which the entities themselves would be subject. If accepted, this principle would eviscerate *in pari delicto.* In the typical case in which the doctrine plausibly is invoked, it is because faithless corporate insiders committed misconduct that an innocent party later wished to disavow in order to state a claim on behalf of the corporation. By definition, if the insiders' fraud were ongoing, the innocent claimant either would not have discovered the misconduct yet, or the entity in question might not yet have become insolvent. Sometimes, it is stockholder derivative plaintiffs who bring claims in the name of the corporation after an insider's wrongdoing is discovered and, often, the bad actor or actors have been removed from their position. In other situations, a receiver or trustee may bring claims on behalf of the delinquent or bankrupt entity. In either case, it is tempting to view the innocent claimant as the true plaintiff and to set aside the *in pari delicto* doctrine so as to allow the claim to be brought. As a Vice Chancellor, Chief Justice Strine heard essentially identical arguments in *AIG II,* however, and he rejected them. [201] The same reasoning applies with equal force here. I see no cogent reason for sparing the innocent Receiver the effect of *in pari delicto* while equally innocent stockholders or policyholders would be barred from relief in the derivative context. [202]

***28** Nor is the avoidance of *in pari delicto* supported by the Receiver's appeal to the public policy interests extant in the context of insurance company delinquency generally, or that of captive insurance companies in particular. As the Receiver points out, insurance is a heavily regulated industry in Delaware and every other state. An entire title (Title 18) of the Delaware Code governs insurance companies, and an entire chapter therein is devoted to captive insurers. [203] Pursuant to the Insurance Code, the State has vested the Insurance Commissioner with significant authority to enforce the relevant law and its corresponding administrative regulations. [204]

There are strong reasons for creating and maintaining a robust regulatory framework regarding insurance. In general, the "reach of influence and consequence" of insurance companies have long been considered "beyond and different from that of the ordinary business." [205] As relevant to this case, Delaware has a particularly significant interest in regulating insurance companies domiciled here, whose assets purportedly exceed $500 billion in the aggregate, making the Department of Insurance the largest consumer protection agency in the state. [206] All these considerations buttress the proposition that the public has an interest in keeping insurers solvent and in overseeing or facilitating the orderly disposition of insolvent or delinquent ones.

Accepting the Receiver's premise, however, does not lead inexorably to the conclusion she urges. For starters, the claims subject to the pending motions to dismiss are the SPI Entities' claims, not the Insurance Commissioner's. Moreover, even setting that aside, the expansive and intricate statutory and regulatory framework governing Delaware-domiciled insurance companies arguably cuts *against* the Receiver's position that *in pari delicto* should not apply, not in favor of it. The essence of her argument is that, if I decline on the basis of public policy to allow Wilmington Trust and the Auditor Defendants to invoke the *in pari delicto* defense, the State's policy goals will be furthered in two ways: (1) the Moving Defendants, if ultimately held liable, can contribute to making the SPI Entities' innocent policyholders whole; and, (2) the Commissioner can incentivize better behavior on the part of firms providing management and auditing services to captive insurers.

As discussed above, the proper inquiry in considering whether to apply the "public policy" exception to *in pari delicto*—which itself serves important public policy objectives—is whether "preclusion of suit would not significantly interfere with the effective enforcement" of a statutory policy scheme. [207] In the case of Delaware insurance regulation, however, no private enforcement scheme exists; to the contrary, the DDOI has been given significant authority to achieve the goals of making innocent insurance policyholders whole, and deterring bad conduct on the part of firms providing professional services to insurers. [208] The statute does not suggest that the Legislature intended private causes of action to play a part in its enforcement, [209] and the Receiver has not cited any case law indicating otherwise.

***29** In this regard, I also note that, with respect to *captive* insurance companies specifically, the Commissioner has even broader authority: in addition to the numerous reporting and minimum capitalization requirements noted in Section I.B *supra,* captive insurance companies are required to select from among audit firms and "captive managers" that are pre-approved by the Insurance Commissioner. [210] In other words, if the misconduct in this case is deemed to be grave enough, the Commissioner presumably could impose some sort of administrative sanction against Wilmington Trust, Johnson Lambert, or McSoley McCoy, or, perhaps, even remove one or more of them from the list of pre-approved service providers.

If the Commissioner is unable to achieve what she deems appropriate levels of consumer protection and industry deterrence, she has been delegated the authority to promulgate further regulations consistent with the insurance statute. [211] Finally, if the statutory tools thus far granted to the DDOI are insufficient, it is the province of the Delaware General Assembly, not this Court, to provide a tailored solution, in a process open to all relevant stakeholders and capable of balancing the numerous, and sometimes competing, considerations democratically.

For all of the foregoing reasons, I am not convinced that public policy would be better served by preventing defendants from relying on the defense of *in pari delicto* merely because the commercial backdrop is that of insurance. Indeed, because of the highly regulated nature of insurance in this State, I do not consider it appropriate to undermine the policies advanced by the *in pari delicto* doctrine, when the purported benefits of doing so here appear to be achievable within the robust regulatory framework that already exists.

5. Should Delaware law recognize a common law "auditor exception" to *in pari delicto?*

At this point in my analysis, the imputation of Jackson's knowledge and actions to the SPI Entities is presumed, and *in pari delicto* applies to bar the Receiver from asserting the SPI Entities' claims, unless I accept the Receiver's final argument in favor of a special "auditor exception" to the doctrine. In asking this Court to recognize an "auditor exception" to the *in pari delicto* doctrine, the Receiver seeks adoption of her interpretation of the dictum in *AIG I* to the effect that, were he able to address the applicability of *in pari delicto* to bar AIG's claims against PwC under Delaware law, then-Vice Chancellor Strine may not have applied the doctrine. Viewing the dictum in *AIG I* in context with the rest of Delaware corporate case law, I do not read our precedent as supporting the broad carve-out from *in pari delicto* that the Receiver urges. I do agree, however, with the sentiment voiced in *AIG I* and *AIG II* that auditors are different from genuine third parties when it comes to analyzing whether *in pari delicto* should apply, and they ought not be afforded the protection of that rule based on a rote application of agency law principles. As those considerations relate to the particular facts of this case, I conclude, for the reasons that follow, that the claims against Wilmington Trust and the Auditor Defendants for breach of contract and negligence must be dismissed. I decline to dismiss, however, the claims against those Defendants for aiding and abetting breaches of fiduciary duty.

Before focusing on Delaware law, I note that several states have created specific exceptions from *in pari delicto* to allow corporations claims' against auditors to proceed. For example, in *NCP Litigation Trust v. KPMG LLP,* the Supreme Court of New Jersey held that a liquidation trustee was not barred from bringing a negligence claim against an auditor whose alleged negligence contributed to the damages caused by the fraud of the liquidated corporation's insiders. [212] The court placed limitations on the holding in *NCP Litigation Trust,* however. Specifically, an auditor retains the right to raise the "imputation defense," as it is called there, against a stockholder who had participated in the fraud, or defendants who by reason of their role in the company should have known about the fraud but did not, or stockholders whose stake in the company was large enough that they should have been able to exercise some oversight over company operations. [213] Because the *NCP* rule is intended to allow "only 'innocent' shareholders to recover," the court expressly noted that the assessment of relative fault in this regard is a factual question that generally requires development of the factual record through discovery and trial. [214]

***30** The Supreme Court of Pennsylvania also responded to a fact pattern involving alleged auditor participation in corporate insiders' fraud by qualifying its *in pari delicto* doctrine, although it took a slightly different tack. [215] There, the Pennsylvania Court based its determination of whether the insiders' fraud should be imputed to the corporation to bar claims against co-wrongdoers (including auditors) on a test of good faith. That is, while imputation generally applies under Pennsylvania law, the court precluded reliance on the *in pari delicto* defense by an auditor that "has not dealt materially in good faith with the client-principal," with the goal of foreclosing application of the doctrine in "scenarios involving secretive collusion between officers and auditors to misstate corporate finances to the corporation's ultimate detriment." [216]

As noted above, the Court of Appeals of New York in *Kirschner* strictly adhered to the traditional *in pari delicto* defense. The discussions and reasoning contained in the *NCP Litigation Trust*, *AHERF*, and *Kirschner* decisions are enlightening on this issue, but none of them are controlling, nor do I consider their logic dispositive of the issue before me.

a. Neither the case law nor public policy support a blanket "auditor exception" to *in pari delicto*

The Receiver asks this Court to interpret Delaware's formulation of the *in pari delicto* doctrine as not applying to any claims against auditors. In making that argument, she relies on: (1) *AIG I* and *AIG II;* and (2) policy-based reasoning. [217] I am not persuaded that either the rationale of the *AIG* decisions or general policy considerations support such a sweeping exception to *in pari delicto.*

First, as the Receiver correctly notes, *AIG I* does suggest that Delaware law should approach on its own terms the question of whether auditors can raise *in pari delicto,* and not mechanically follow the approach of New York or any other state. When read alongside *AIG II,* as it must be, however, the rationale of *AIG I* does not support veering to the opposite extreme by entirely setting aside *in pari delicto* to allow any and all claims against auditors. The *AIG I* opinion observes, for example, that "one can quibble with [the New

York approach] while still having doubt about the public policy utility of exposing audit firms to uncapped liability for their negligent failure to detect financial fraud by corporate managers." [218] In that vein, then-Vice Chancellor Strine briefly noted that "a more thoughtful tact" would not involve simply allowing any and all causes of action against auditor defendants to proceed, but rather would seek responsibly to calibrate the auditors' *ex post* liability through the use of heightened standards of pleading, liability, and proof, and damages caps. [219] In that regard, the Court noted in *AIG I* that "[a]lthough audit fees are lucrative, they arguably pale in comparison to the potential liability the auditors face," and going too far in the direction of imposing *ex post* liability can backfire. [220]

***31** Moreover, in deciding which law applied in *AIG I,* the Court expressly considered the Delaware public policy interests that could have been furthered by refusing to apply New York law (and possibly precluding PwC from asserting the *in pari delicto* defense). [221] The Court ultimately concluded, however, that those considerations do not trump our choice-of-law principles and the policy goals they protect. To the extent the Receiver relies on *AIG I* as supporting the proposition that all other policy interests must yield to the benefits that arguably flow from precluding auditors from raising the *in pari delicto* defense, I find that reliance misplaced.

Second, I question the policy arguments the Receiver makes in favor of a broad exception to *in pari delicto* for any and all claims against auditors. A theme of the Receiver's argument in this case, and in decisions like *AHERF*and *NCP,* is that allowing *in pari delicto* to bar claims against auditors essentially would subvert two policy goals in that: (1) innocent stockholders and creditors who were harmed would be deprived of a remedy for that harm; and (2) auditor misconduct, either knowing or negligent, would go unpunished. I consider both of those contentions misguided.

With the first, a flawed premise is disguised by noble sentiment. For starters, *in pari delicto* only acts to bar claims that in fact belong to the corporation, so it would not preclude a stockholder or creditor who suffered a *direct* harm from bringing a direct claim to redress it. Even in cases where it might apply, however, *in pari delicto* will not bar the corporation from suing its faithless fiduciaries, because of the fiduciary duty exception. Thus, the corporation has at least some remedy for wrongs done and a source for recoupment of its losses.

Even if concern for innocent stockholders were considered the most important factor, however, making the defense of *in pari delicto* unavailable to auditor defendants would be problematic. Adopting such a rule would mean that a wrongdoer-corporation gets to sue its auditor and cause the innocent residual claimants of that firm to bear the cost of the lawsuit and any damages, while residual claimants of true third-party co-conspirators (like Gen Re, Marsh, or ACE in *AIG II*) would enjoy the protection of *in pari delicto.* The imbalance of such a rule is especially pronounced where the audit firm is allegedly negligent, while the corporation's fiduciaries and the agents of the third-party co-conspirators are accused of purposefully engaging in fraud.

A second main policy contention proffered by the Receiver —that carving out an auditor exception from *in pari delicto* would undermine efforts to encourage auditors to do a better job monitoring—takes a blinkered view of the world. It is one thing to accept the premise that our corporate law should not automatically dismiss on *in pari delicto* grounds all claims against auditors in cases involving serious corporate misconduct. It is a significant leap, however, to conclude from that premise that the best policy answer is to open a floodgate of *ex post* auditor liability.

The independent auditor undoubtedly plays a central role in effectuating important public policies implicated in corporate law, such as investor protection, efficient capital markets, and good corporate governance. Auditors are so central, in fact, that there are numerous governmental and non-governmental bodies currently regulating and otherwise overseeing the audit industry. [222] Thus, to the extent it is suggested that the blunt instrument of ex-post liability in contract or tort will cause auditors to do their jobs better, it is questionable whether this Court would have much to add in this already well-covered field. The best-case scenario is that the Court adequately understands and applies the applicable audit standards and generally accepted accounting principles ("GAAP") equally as well as the relevant regulatory body whose core jurisdiction such issues fall under. Even if the Court succeeds at that endeavor, the results—from the perspective of auditor monitoring and deterrence—ideally should be duplicative. Thus, the benefits in terms of auditor deterrence would likely be more limited than the Receiver suggests.

***32** For those reasons, I find that the purported benefits (in terms of investor protection and auditor deterrence) of creating an exception to *in pari delicto* for all claims against auditors are not sufficient to justify undermining the policy principles girded by the doctrine, which protect the Court from accounting among wrongdoers. In addition to the lack of persuasive benefits associated with that kind of sweeping exception, some negative outcomes likely would flow from it. In that regard, one consideration is whether it makes sense for a court of equity to purport to place itself on the level of, for example, the SEC, the PCAOB, the AICPA, or the State Board of Accountancy in terms of evaluating the performance of auditors. With respect to monitoring auditors, the experience and sophistication of those or other relevant audit and accounting regulatory bodies is beyond that of law-trained judges, and their capacity to govern the audit industry is appropriate for the scale of that endeavor. In my view, this Court should avoid entangling itself unnecessarily in time- and resource-consuming inquiries about whether GAAP and relevant audit standards were met, which would be the foreseeable outcome if, for example, *in pari delicto* did not bar contract and negligence claims in cases like this one. Because regulatory bodies exist for conducting such inquiries, I consider it ill-advised to insert this Court into matters within the core mandate of those bodies.

b. Well-pled aiding and abetting claims against defendants like auditors should not be barred by *in pari delicto*

Although the *AIG* decisions and the public policy considerations just discussed do not point to a sprawling exception from *in pari delicto* for any and all claims against auditors, they do support a more limited exception grounded in both the nature of the claim asserted and the party likely to raise *in pari delicto* to bar that claim. As discussed, Delaware law sets aside *in pari delicto* when a receivership trustee or derivative plaintiff seeks to sue the corporation's own fiduciaries for breach of their fiduciary duties. Applying the same reasoning, I conclude that Delaware law should do the same where an auditor or similar defendant is alleged to have aided and abetted such breach. Rather than create an expansive new "auditor exception" to *in pari delicto,* therefore, I determine that the fiduciary duty exception extends to cover well-pled aiding and abetting claims against defendants like auditors. Thus, in this case, the claims against the Wilmington Trust and the Auditor Defendants for breach of contract and negligence will be barred by *in pari delicto,* but the claims against them for aiding and abetting breaches of fiduciary duty will not.

Both *AIG I* and *AIG II* recognize that defendants like auditors should be treated differently than other third parties when it comes to *in pari delicto. AIG I*also made the nuanced observation that claims against a defendant like PwC for aiding and abetting a breach of fiduciary duty would be materially different from breach of contract or negligence claims against PwC. Then–Vice Chancellor Strine placed "an important caveat" on his decision not to apply Delaware law in *AIG I,* observing that had the stockholder derivative plaintiffs there stated claims against PwC for aiding and abetting breaches of fiduciary duty, his choice of law analysis might have been "quite different." [223] But "[b]ecause PWC only face[d] claims for malpractice and breach of contract, rather than claims that it consciously aided wrongful managerial misconduct," he applied New York law and ultimately dismissed all claims as New York law required him to. [224]

I agree that claims for aiding and abetting breaches of fiduciary duty differ materially from contract and negligence claims, because with the former, the corporation's internal affairs are the focus of the claim. [225] The policy goals advanced by *in pari delicto,* while important enough to outweigh this Court's interest in adjudicating breaches of contract and negligence claims at the periphery of a corporation's affairs, should not outweigh the importance of this Court's ability to adjudicate core fiduciary duty claims arising out of entities organized under Delaware law.

***33** *AIG II* gives a further, equally critical insight, however: not all aiding and abetting claims are created equal. Thus, in *AIG II,* the Court applied Delaware law to dismiss aiding and abetting claims that the stockholder derivative plaintiffs sought to prosecute against the third-party co-conspirators (Gen Re and Marsh). The lack of analogous aiding and abetting claims was notable in *AIG I,* but that distinction was mentioned only in passing in *AIG II.* [226]

The distinction in the *AIG* cases between third parties like ACE, Gen Re, and Marsh on one hand and PwC on the other comports with the reality that non-fiduciaries like auditors, who occupy a position of trust and materially participate in the traditional insiders' discharge of their fiduciary duties, are different from other third parties with whom the corporation may transact business. [227] For purposes of the motions currently before me, I need not dilate upon this distinction, because it is evident from the face of the Complaint that both Wilmington Trust and the Auditor Defendants are alleged to have played a "gatekeeper" role vis-à -vis the SPI Entities. On that basis alone, the aiding and abetting claims against them are fundamentally unlike those that were dismissed in *AIG II.*I conclude, therefore, that *in pari delicto* does not provide grounds for dismissing the aiding and abetting claims against Wilmington Trust and the Auditor Defendants.

c. The Complaint states claims for aiding and abetting breaches of fiduciary duty against Wilmington Trust and Johnson Lambert, but not McSoley McCoy

For the reasons stated in the preceding Sections, the Receiver's claims against Wilmington Trust and the Auditor Defendants for breach of contract and negligence are dismissed on grounds of *in pari delicto*, but the claims for aiding and abetting breaches of fiduciary duty are not. As I next discuss, the Complaint adequately states aiding and abetting claims as to Wilmington Trust and Johnson Lambert, but not as to McSoley McCoy. [228]

***34** To survive a motion to dismiss, a complaint must allege facts that satisfy the four elements of an aiding and abetting claim: (1) the existence of a fiduciary relationship, (2) a breach of the fiduciary's duty, (3) knowing participation in that breach by the defendants, and (4) damages proximately caused by the breach. [229]

As to the existence of fiduciary duties, alleged breaches thereof, and resulting damages, the Complaint contains allegations sufficient to support a reasonable inference of two general types of breach, both amply discussed in this Opinion: (1) the purposeful fraud ascribed to James M. Jackson; and (2) the alleged failure on the part of at least the SPI Entities' director Kantner to exercise sufficient oversight, in breach of his duty of loyalty. Thus, as with most cases involving aiding and abetting liability, the sufficiency of the claims against the Moving Defendants in this regard "largely come[s] down to what constitutes 'knowing participation.' " [230] Specifically, the relevant inquiry is whether it is reasonably conceivable, based on the non-conclusory allegations in the Complaint and all reasonable inferences drawn from them, that Wilmington Trust, Johnson Lambert, and McSoley McCoy "knowingly participated" in either of the alleged breaches described in items (1) and (2) here.

At this preliminary stage of the litigation, I cannot rule out the possibility, based on the allegations in the Complaint, that Wilmington Trust and Johnson Lambert knowingly participated in James M. Jackson's fraudulent scheme in breach of his fiduciary duties. I need not decide that question for purposes of the pending motions to dismiss the aiding and abetting claim, however, because it also is reasonably inferable that Wilmington Trust and Johnson Lambert knowingly participated in, at least, the breaches of fiduciary duty allegedly committed by the SPI Entities' other directors, in the critical sense that they "*created* the unreasonable process and informational gaps that led to the Board's breach of duty." [231]

Drost and Theriault of Wilmington Trust worked hand-in-glove with Handy and Bolton of Johnson Lambert to prepare the 2007 and 2008 Audited Financial Statements. Those processes were replete with alleged irregularities, and it is reasonable at this stage to infer that both Wilmington Trust and Johnson Lambert knew something was significantly wrong within the SPI Entities' operations. In one of the more glaring episodes detailed in the Complaint, after receiving bank account confirmations from Wachovia and Bank of America that widely diverged from the information provided by Jackson, Handy and Drost followed Jackson's instructions to talk to "Alpesh" in order to straighten things out. At one point, Drost and Handy actually discussed how strange it was that their given contact person for Wachovia bank was the same as for Wachovia Securities, in light of the strict separation of those units normally observed within Wachovia's structure. Drost knew something was wrong, or at least it is reasonably inferable that he did, when he stated "maybe, and hopefully [it was] OK" that "Alpesh" was the contact person for both. But Drost's disbelief was evident in his saying that they should try to contact both sides of the Wachovia structure to figure out why all of the huge discrepancies "suddenly" were explained away. [232] Lengthy and unexplained delays occurred, but were not challenged by Wilmington Trust or Johnson Lambert in trying to resolve this issue. When, months after he initially inquired, Bolton finally heard from "Alpesh," the explanation Alpesh gave did not convince either Bolton or Drost. Nevertheless, Drost concocted what he admitted was an "optimistic" re-interpretation of Alpesh's story, and on that basis he checked the final boxes and Wilmington Trust and Johnson Lambert marked the 2007 Audited Financial Statements complete, nearly a year after they set out to complete it. [233]

***35** These alleged facts are only examples, and perhaps they and the numerous other relevant facts alleged in the Complaint conceivably could be explained away as negligence, or perhaps gross negligence, on the part of Wilmington Trust and Johnson Lambert. One instance where they conceivably cross the threshold of "scienter," however, is in connection with those entities advising the SPI Entities' Boards at the meetings in February and October 2009. Drost, Theriault, and (presumably) Kantner of Wilmington Trust were in attendance at those Meetings, at which the Johnson Lambert audited financial statements were approved with little or no discussion. In connection with the February 2009 Meeting and the 2007 Audited Financial Statements, Johnson Lambert advised the directors in the Significant Matters Letters that the audit irregularities already had been addressed. The facts alleged in the Complaint, however, suggest that they knew otherwise—as evidenced, at least, by the fact that the same difficulties came up the following year. The Jackson Letter further suggested that certain procedures should be improved in connection with the bank account reconciliations. At a later point, Wilmington Trust advised Jackson that they wanted to have direct access to the bank accounts so that they could confirm balances without going through Jackson.

Those suggestions and requests were ignored by Jackson, but neither Wilmington Trust nor Johnson Lambert ever attempted to follow up with the other directors. Though the situation in terms of the audit irregularities apparently did not improve between the February 2009 Meeting and the October 2009 Meeting, Johnson Lambert did not send another Significant Matters Letter or otherwise update the Boards. It is reasonably inferable, therefore, that both Wilmington Trust and Johnson Lambert *knew* that the directors were not informing themselves and not exercising their oversight responsibility, when those Defendants arguably first presented the "significant matters" as being less of a problem than they actually were, and then allowed the directors to ignore the letters and the suggestions contained within them. This knowing lack of follow-up directly created the "unreasonable process" and "informational gaps" that are alleged to have led to the Board's breaches of fiduciary duties. [234] Accordingly, I refuse to dismiss the claims asserted by the Receiver against Wilmington Trust and Johnson Lambert for aiding and abetting a breach of fiduciary duty.

The situation is materially different with respect to McSoley McCoy. It reasonably might be inferred that they conducted their audit process in a negligent or even grossly negligent manner because, like Johnson Lambert, McSoley McCoy apparently relied on the mysterious Alpesh, and unquestioningly accepted the forged fax copy of the confirmation form regarding the Key Man Policy without following up to obtain the original of that document from Hartford Life. But, McSoley McCoy entered the picture much later than Johnson Lambert, and the Complaint alleges that it largely followed the process that Wilmington Trust laid out as being "routine" for the SPI Entities' audits. The critical link in the factual allegations regarding Wilmington Trust and Johnson Lambert was their knowing failure to follow up on the original warnings they provided to the Board in connection with the first audit, despite experiencing very similar irregularities the next year. McSoley McCoy, however, was not around long enough to have engaged in such a dereliction of their responsibilities. Thus, the Complaint fails to allege sufficient facts as to McSoley McCoy to support a reasonable inference that it "knowingly" participated in the Board's alleged breaches of fiduciary duty. I therefore dismiss the aiding and abetting claim as it relates to McSoley McCoy.

III. CONCLUSION

For the reasons stated in this Opinion, I dismiss the claims for breach of fiduciary duty against Wilmington Trust and the Auditor Defendants for failure to state a claim. The motion to dismiss the claim for breach of fiduciary duty against Kantner, however, is denied. The claims for negligence and breach of contract as to Wilmington Trust and the Auditor Defendants are dismissed on grounds of *in pari delicto.* I further conclude that the claims against those Defendants for aiding and abetting a breach of fiduciary duty are not subject to the *in pari delicto* defense, and that the claims in that regard against Wilmington Trust and Johnson Lambert are well-pled. Accordingly, I deny the motion to dismiss the aiding and abetting claims against Wilmington Trust and Johnson Lambert. I grant the motion of McSoley McCoy, however, to the extent it seeks dismissal of the aiding and abetting claim against it, because in that respect the Complaint fails to state a claim upon which relief could be granted.

***36** In summary, I grant the motions to dismiss Counts 1 through 10. Count 11 is dismissed as to Wilmington Trust, but not as to Kantner. [235] I grant dismissal of Count 12 as to McSoley McCoy and Kantner, but not as to Wilmington Trust or Johnson Lambert.

IT IS SO ORDERED.

Footnotes

1 All facts recited herein are drawn from the well-pled allegations of Plaintiff's Verified Complaint (the “Complaint”).

2 *In re Liquid. of Sec. Pac. Ins. Co.,* C.A. No. 6317–VCP, at 17 (Del. Ch. June 15, 2011) (ORDER) (the “Liquidation Order”); *see also In re Liquid. of Sec. Pac. Ins. Co.,* C.A. No. 6317–VCP (Del. Ch. June 28, 2011) (the “Motion for Liquidation Transcript”).

3 The Receiver voluntarily dismissed the claims against Ryan Building Group on April 10, 2014. As noted *infra* in Section I.C, I dismissed the Complaint as it relates to James L. Jackson and Anthony Muñoz on August 12, 2014.

4 The Receiver alleges that Johnson Lambert & Co., LLP's rights, duties, and liabilities were assumed by Johnson Lambert, LLP in 2012. Compl. ¶ 14. Johnson Lambert asserts that the underlying company always has been the same; it simply changed its name from the former to the latter. Because this point is immaterial to the pending motions, I refer only to “Johnson Lambert” for the remainder of this Opinion.

5 *See generally*18 *Del. C.* §§ 6901 to 6983.

6 Because Defendant James L. Jackson has been dismissed from this action, the use of the name “Jackson” in this Opinion refers to Defendant James M. Jackson.

7 According to the application documents, Jackson represented that Security Pacific, SPI–202, SPI–203, and SPI–204 would hold initial capital amounts, respectively, of $962,792; $639,051; $349,356; and $698,968. Compl. ¶¶ 63–67.

8 Compl. ¶¶ 68–69; *id.*Ex. B.

9 *Id.* ¶¶ 71–80; *id.*Ex. C.

10 18 *Del. C.* §§ 6903(b), 6923.

11 Compl. ¶¶ 74, 88.

12 *Id.* ¶¶ 81–82.

13 *Id.* ¶¶ 83–85.

14 *Id.* ¶ 89; *id.*Ex. D [hereinafter the “2007 Johnson Lambert Engagement Letter”].

15 *Id.* ¶¶ 64, 100, 103.

16 *Id.* ¶¶ 100–101.

17 *Id.* ¶¶ 106–108.

18 *Id.* ¶¶ 110–114.

19 *Id.* ¶¶ 127–128.

20 *Id.* ¶ 130.

21 *Id.* ¶ 132.

22 *Id.* ¶¶ 129, 133.

23 *Id.* ¶¶ 167–168.

24 *Id.* ¶¶ 184–185.

25 *Id.* ¶ 187.

26 *Id.* ¶¶ 189–191.

27 *Id.* ¶¶ 121–123.

28 *Id.* ¶¶ 135–137.

29 *Id.* ¶¶ 138–141.

30 *Id.* ¶ 147.

31 *Id.* ¶ 145.

32 *Id.* ¶ 149.

33 *Id.* ¶¶ 152–153.

34 *Id.* ¶ 156.

35 *Id.* ¶ 157.

36 *Id.* ¶¶ 160, 162.

37 *Id.* ¶ 162.

38 *Id.* ¶¶ 165–166.

39 *Id.* ¶¶ 171–172.

40 *Id.* ¶ 174.

41 *Id.* ¶ 175.

42 *Id.* ¶ 204.

43 *Id.* ¶ 206.

44 *Id.* ¶ 209.

45 *Id.* Ex. F [hereinafter “Significant Matters Letter”].

46 *Id.* ¶ 217.

47 *Id.* ¶ 218; *id.*Ex. G [hereinafter “Jackson Letter”].

48 *Id.* ¶ 216.

49 *Id.* ¶¶ 223–224.

50 *Id.* ¶¶ 227–238.

51 *Id.* ¶¶ 239–253. In this regard, I also note that Johnson Lambert received a letter from Hartford Life in June 2009, indicating that Johnson Lambert's confirmation form could not be processed because it was not signed by the policy owner. According to the Receiver, this was another red flag because Johnson Lambert had not sent a confirmation form to Hartford Life; rather, it is alleged that Jackson had emailed Hartford Life a form that was intended for Handy of Johnson Lambert to submit to Hartford Life. *Id.* ¶¶ 243–244.

52 *Id.* ¶ 269.

53 *Id.* ¶¶ 270–272.

54 Jackson Letter 2.

55 Compl. ¶¶ 274–279.

56 *Id.* ¶ 282; *id.*Ex. I.

57 *Id.* ¶ 287.

58 *Id.*

59 *Id.* ¶ 291.

60 *Id.* ¶ 299.

61 *Id.* ¶ 302.

62 *Id.* Ex. K.

63 *Id.*

64 *Id.* ¶ 311.

65 *Id.* ¶¶ 312–316.

66 As to Johnson Lambert, two separate counts for breach of contract are pled, one each for the 2007 and 2008 engagement agreements.

67 *Stewart v. Wilm. Trust SP Servs., Inc.,* C.A. No. 9306–VCP, at 25–26 (Del. Ch. Aug. 12, 2014) (TRANSCRIPT). In that ruling, I concluded based on the factual allegations in the Complaint that it was not reasonably conceivable that Muñoz or James L. Jackson could be found liable on a *Caremark* theory of director oversight liability. In part, I based that conclusion on the fact that the boards had retained and received reports from independent auditors, Johnson Lambert and McSoley McCoy. *Id.* at 16–17, 25.

68 The briefing on these motions is voluminous, consisting of three separate briefs in both the opening and reply rounds—one each for Wilmington Trust and Kantner, Johnson Lambert, and McSoley McCoy. The Receiver filed two answering briefs, one in response to Wilmington Trust and Kantner, and one combined response to the Auditor Defendants' motions. I cite the briefs as, for example, “Wilm. Trust Opening Br.,” “Receiver's Answering Br. to Auditor Defs.,” and so on.

69 Wilm. Trust Opening Br. 31; McSoley McCoy Opening Br. 15 n.1.

70 Johnson Lambert Opening Br. 30, 33–37.

71 Receiver's Answering Br. to Auditor Defs. 46–47.

72 I am mindful that, depending on the law of the states whose law arguably might apply, there may not be a conflict and the choice of law issue would be moot. *See Deuley v. DynCorp Int'l, Inc.,* 8 A.3d 1156, 1161 (Del.2010) (“As we explain below, the result would be the same under both Delaware and Dubai law. Therefore ‘[a]ccording to conflicts of law principles ... there is a ‘false conflict,’ and the Court should avoid the choice-of-law analysis altogether.' ”). But it is difficult to assess that question on the incomplete briefing record before me. I therefore provide the analysis that follows in the interest of completeness and to facilitate appellate review.

73 *See VantagePoint Venture P'rs 1996 v. Examen, Inc.,* 871 A.2d 1108, 1113 (Del.2005) (“It is now well established that only the law of the state of incorporation governs and determines issues relating to a corporation's internal affairs.”) (citing *CTS Corp. v. Dynamics Corp. of Am.,* 481 U.S. 69, 89–93, 107 S.Ct. 1637, 95 L.Ed.2d 67 (1987)).

74 Counts 1, 4, 8, and 11 plead claims for breaches of fiduciary duty against Wilmington Trust, Johnson Lambert, McSoley McCoy, and the SPI Entities' directors (including Kantner).

75 *VantagePoint Venture P'rs 1996,* 871 A.2d at 1113 n.14.

76 *See Travelers Indem. Co. v. Lake,* 594 A.2d 38, 41, 47 (Del.1991). Although I need not reach the issue, I would expect to apply Delaware law to the aiding and abetting causes of action here. Wilmington Trust and Kantner assert that aiding and abetting liability sounds in tort, and there is support for that proposition. *See, e.g., In re Rural/Metro Corp. S'holders Litig.,* 102 A.3d 205, 220 n.1 (Del. Ch.2014). Because liability for aiding and abetting a breach of fiduciary duty depends in part on the finding of an underlying fiduciary duty and a breach of that duty—issues that in this case, under the internal affairs doctrine, would turn on Delaware law—it would seem illogical to apply another state's law to the "tort" of aiding and abetting such a breach, even if the most significant relationship test pointed to that result. *Cf. In re Am. Int'l Gp., Inc. Consol. Deriv. Litig.,* 965 A.2d 763, 822 (Del. Ch.2009) [hereinafter "*AIG I* "], *aff'd sub nom.Teachers' Ret. Sys. of La. v. PricewaterhouseCoopers LLP,* 11 A.3d 228 (Del.2011).

77 RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 145 (1971).

78 *Id.* § 188.

79 *TrustCo Bank v. Mathews,* 2015 WL 295373, at *9 (Del. Ch. Jan. 22, 2015).

80 Compl. ¶¶ 29, 43–46.

81 *Id.* ¶ 42.

82 *Id.* ¶ 87.

83 *Id.* ¶ 97.

84 *Id.* Ex. I.

85 *In re Am. Int'l Gp., Inc., Consol. Deriv. Litig.,* 976 A.2d 872, 882 (Del. Ch.2009) [hereinafter "*AIG II* "].

86 *Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Hldgs. LLC,* 27 A.3d 531, 536 (Del.2011).

87 *Id.*

88 *Price v. E.I. duPont de Nemours & Co., Inc.,* 26 A.3d 162, 166 (Del.2011).

89 Wilm. Trust Opening Br. 28–30; Johnson Lambert Opening Br. 24–28; McSoley McCoy Opening Br. 21–23.

90 *See*10 *Del. C.* § 8106; *Sunrise Ventures, LLC v. Rehoboth Canal Ventures, LLC,* 2010 WL 363845, at *6 (Del. Ch. Jan. 27, 2010), *aff'd,*7 A.3d 485 (Del.2010).

91 Receiver's Answering Br. to Wilm. Trust 19–26; Receiver's Answering Br. to Auditor Defs. 48–56.

92 *TrustCo Bank,* 2015 WL 295373, at *5.

93 *IAC/InterActiveCorp v. O'Brien,* 26 A.3d 174, 177 (Del.2011).

94 *Id.* at 177–78.

95 *Id.* at 178. Factors that guide this analysis include: "1) whether the plaintiff had been pursuing his claim, through litigation or otherwise, before the statute of limitations expired; 2) whether the delay in filing suit was attributable to a material and unforeseeable change in the parties' personal or financial circumstances; 3) whether the delay in filing suit was attributable to a legal determination in another jurisdiction; 4) the extent to which the defendant was aware of, or participated in, any prior proceedings; and 5) whether, at the time this litigation was filed, there was a bona fide dispute as to the validity of the claim." *Id.*

96 *See In re Liquid. of Sec. Pac. Ins. Co.,* C.A. No. 6317–VCP, Docket Item ("D.I.") Nos. 5–8.

97 *Id.,* D.I. Nos. 44, 70; *see also In re Liquid. of Sec. Pac. Ins. Co.,* C.A. No. 6317–VCP, at 1, 2012 WL 1764227 (Del. Ch. May 10, 2012). One of the original Defendants in this action, Ryan Building Group, disputed the authority of the Receiver in that regard in the Liquidation Action.

98 *E.g., In re Liquid. of Sec. Pac. Ins. Co.,* C.A. No. 6317–VCP, D.I. Nos. 48–51, 54.

99 *Id.,* D.I. No. 52.

100 *Id.,* D.I. Nos. 107, 114, 144, 145, 158.

101 *E.g.,* Compl. ¶¶ 171–175, 205–209.

102 *See IAC/InterActiveCorp,* 26 A.3d at 178.

103 *Reid v. Spazio,* 970 A.2d 176, 183 (Del.2009) (quoting 2 JOHN NORTON POMEROY, EQUITY JURISPRUDENCE §§ 418, 419 (5th ed. 1941)).

104 *Reid,* 970 A.2d at 183.

105 *Id.*

106 *IAC/InterActiveCorp,* 26 A.3d at 177.

107 *Id.*

108 Defendant McSoley McCoy did not provide audit services until 2010 in connection with the 2009 Audited Financial Statements. Because the claims against McSoley McCoy arose significantly later than the claims against Wilmington Trust and Johnson Lambert, but otherwise also are affected by the alleged fraud by Defendant Jackson and wrongdoing by the Moving Defendants, referenced *infra,* I consider it unnecessary to discuss separately McSoley McCoy's laches defense in this regard.

109 In that regard, I note that the DDOI sought appointment of the Receiver less than a month after they were advised by Wilmington Trust that there might be a problem.

110 As discussed below, the *in pari delicto* defense is not applicable to well-pled claims for breach of fiduciary duty, so I do not address that defense in this section of the Opinion. *See infra* notes 148–53 and related text.

111 Compl. ¶ 371.

112 *See In re Mobilactive Media, LLC,* 2013 WL 297950, at *21 (Del. Ch. Jan. 25, 2013).

113 Receiver's Answering Br. to Auditor Defs. 64–67.

114 *In re USACafes, L.P. Litig.,* 600 A.2d 43, 48 (Del. Ch.1991).

115 *Id.* ("There are, of course, other aspects—a fiduciary may not waste property even if no self interest is involved and must exercise care even when his heart is pure—but the central aspect of the relationship is, undoubtedly, fidelity in the control of property for the benefit of another.").

116 *Crosse v. BCBSD, Inc.,* 836 A.2d 492, 495 (Del.2003); *accord USACafes,* 600 A.2d at 48–49.

117 *United States v. Arthur Young & Co.,* 465 U.S. 805, 818, 104 S.Ct. 1495, 79 L.Ed.2d 826 (1984). Many courts that have addressed the question have declined to find a fiduciary relationship between auditor and client. *See, e.g., Franklin Supply Co. v. Tolman,* 454 F.2d 1059, 1065 (9th Cir.1971); *Resolution Trust Corp. v. KPMG Peat Marwick,* 844 F.Supp. 431, 436 (N.D.Ill.1994); *Mishkin v. Peat, Marwick, Mitchell & Co.,* 744 F.Supp. 531, 552 (S.D.N.Y.1990). The Receiver has not cited any case that reached the opposite conclusion.

118 *Bird's Const. v. Milton Equestrian Ctr.,* 2001 WL 1528956, at *4 (Del. Ch. Nov. 16, 2001).

119 Receiver's Answering Br. to Wilm. Trust 28–30.

120 Receiver's Answering Br. to Wilm. Trust 30–32.

121 *Id.* (citing *Blau v. Lehman,* 368 U.S. 403, 82 S.Ct. 451, 7 L.Ed.2d 403 (1962); *U.S. v. Cleveland Trust Co.,* 392 F.Supp. 699 (N.D.Ohio 1974)). In discussing the Receiver's use of the term "de facto director" here, I do not intend any reference to, or to engender any confusion with, the cases in which "de facto director" means "one who is in possession of and exercising the powers of that office *under claim and color of an election,* although he is not a director De jure and may be removed by proper proceedings." *Prickett v. Am. Steel & Pump Corp.,* 253 A.2d 86, 88 (Del. Ch.1969) (emphasis added); *see also Hockessin Cmty. Ctr., Inc. v. Swift,* 59 A.3d 437, 459–60 (Del. Ch.2012). The theory the Receiver advances in this regard has nothing to do with the line of cases dealing with disputed elections and contested board seats.

122 8 *Del. C.* § 141(b).

123 *See, e.g., Gantler v. Stephens,* 965 A.2d 695, 708–09 (Del.2009).

124 Wilm. Trust Opening Br. 34–39; Wilm. Trust Reply Br. 31–33.

125 Receiver's Answering Br. to Wilm. Trust 48–60; *see In re Caremark Int'l Inc. Deriv. Litig.,* 698 A.2d 959 (Del. Ch.1996).

126 *Stone ex rel. AmSouth Bancorp. v. Ritter,* 911 A.2d 362, 370 (Del.2006).

127 *Id.*

128 *In re Caremark,* 698 A.2d at 967.

129 *See*18 *Del. C.* § 6906(f) ("In the case of a captive insurance company ... [f]ormed as a corporation, at least 1 of the members of the board of directors or other governing body shall be a resident of, or have that member's principal place of business in, this State ..."); *id.*§ 6903(b) (requiring a Delaware captive insurance company, *inter alia,* to maintain its principal place of business in this State, and hold at least one board meeting per year here); *see also* Compl. ¶¶ 7, 74.

130 I express no opinion as to the potential *Caremark* liability of any of the SPI Entities' directors other than Kantner, because only Kantner is before me on the pending motions to dismiss.

131 *AIG II,* 976 A.2d at 883 (quoting *In re LJM2 Co–Inv., L.P.,* 866 A.2d 762, 775 (Del. Ch.2004)).

132 *Id.* at 882 (quoting AM. JUR. 2d *Actions* § 40).

133 *Id.* at 882 n. 21; *see also, e.g., Bateman Eichler, Hill Richards, Inc. v. Berner,* 472 U.S. 299, 306, 105 S.Ct. 2622, 86 L.Ed.2d 215 (1985); *Stone v. Freeman,* 298 N.Y. 268, 82 N.E.2d 571, 572 (1948) ("[N]o court should be required to serve as paymaster of the wages of crime, or referee between thieves.")

134 *AIG II,* 976 A.2d at 882 n.21 (quoting *Lewis v. Davis,* 145 Tex. 468, 199 S.W.2d 146, 151 (1947)); *see also* 3 POMEROY,*supra* note 103, § 940 n. 5.

135 *AIG II,* 976 A.2d at 882.

136 *Pinter v. Dahl,* 486 U.S. 622, 632, 108 S.Ct. 2063, 100 L.Ed.2d 658 (1988). In this regard, I note that the full rendition of the legal maxim, *in pari delicto potior est conditio defendentis,* has been translated as, “In a case of equal or mutual fault, the position of the defending party is the better one.” *Berner,* 472 U.S. at 306, 105 S.Ct. 2622. It is the mutuality of fault that gives the doctrine its logical force; if emphasis were to be placed on the equality or relative degree of fault, the court probably would have to find facts and engage in a balancing analysis that would defeat the purpose of having the rule in the first place. *See AIG II,* 976 A.2d at 883–34. “ ‘[H]ypertechnical interpretation of the *in pari delicto* doctrine is outdated’ as ‘it is not necessary that [the] wrongdoing of plaintiff and defendant be clearly mutual, simultaneous, and relatively equal.’ ” *In re Oakwood Homes Corp.,* 389 B.R. 357, 371–72 (D.Del.2008) (quoting *Peltz v. SHB Commodities, Inc.,* 115 F.3d 1082, 1090 (2d Cir.1997)), *aff'd,*356 Fed.Appx. 622 (3d Cir.2009).

137 1 AM.JUR. 2D*Actions* § 40; *see also Kirschner v. KPMG LLP,* 15 N.Y.3d 446, 912 N.Y.S.2d 508, 938 N.E.2d 941, 950 (2010).

138 *See, e.g., AIG II,* 976 A.2d at 878; *Oakwood Homes Corp.,* 389 B.R. at 372.

139 *See, e.g., Teachers' Ret. Sys. of La. v. Aidinoff,* 900 A.2d 654, 671 n.23 (Del. Ch.2006); *Albert v. Alex. Brown Mgmt. Servs., Inc.,* 2005 WL 2130607, at *11 (Del. Ch. Aug. 26, 2005).

140 *See In re Brandywine Volkswagen, Ltd.,* 306 A.2d 24, 27 (Del.Super.), *aff'd sub nom.Brandywine Volkswagen, Ltd. v. State Dep't of Cmty. Affairs & Econ. Dev.,* 312 A.2d 632 (Del.1973).

141 *AIG II,* 976 A.2d at 893.

142 *Id.* at 883–84.

143 *Id.* at 891 n. 50.

144 *Id.* at 891 (emphasis added).

145 *Id.* at 891 (citing *In re CBI Hldg. Co.,* 529 F.3d 432, 453 (2d Cir.2008)).

146 *AIG II,* 976 A.2d at 892.

147 *Cf. Kirschner,* 912 N.Y.S.2d 508, 938 N.E.2d at 950.

148 *AIG II,* 976 A.2d at 876, 889–95.

149 *Id.* at 889–90; *see also In re HealthSouth Corp. S'holders Litig.,* 845 A.2d 1096, 1107 (Del. Ch.2003), *aff'd,*847 A.2d 1121 (Del.2004).

150 *AIG II,* 976 A.2d at 876.

151 *HealthSouth Corp.,* 845 A.2d at 1107.

152 2 POMEROY,*supra* note 103, § 363. This maxim “is the source of the entire equitable jurisdiction, exclusive, concurrent, and auxiliary.” *Id.* at § 423. The doctrine of *in pari delicto,* of course, implicates another of our first principles—that “he who comes into equity must come with clean hands.” *Id.* at §§ 363, 397. *Cf. Seacord v. Seacord,* 33 Del. 485, 139 A. 80, 81 (Del.Super.1927) (discussing “the rule of pari delicto or the equitable maxim, ‘He who comes into court must come with clean hands' ”).

153 *AIG II,* 976 A.2d at 889.

154 *Id.* at 888.

155 *See Perma Life Mufflers, Inc. v. Int'l Parts Corp.,* 392 U.S. 134, 136, 88 S.Ct. 1981, 20 L.Ed.2d 982 (1968) (reversing lower federal court rulings that “seemed to threaten the effectiveness of the private action as a vital means for enforcing the antitrust policy of the United States”); *see also Pinter,* 486 U.S. at 633, 108 S.Ct. 2063 (stating that, in the context of the federal securities laws, courts must ensure that “judge-made law” like *in pari delicto*“does not undermine the congressional policy favoring private suits as an important mode of enforcing federal securities statutes”); *Berner,* 472 U.S. at 315, 105 S.Ct. 2622.

156 *AIG I,* 965 A.2d 763; *AIG II,* 976 A.2d 872.

157 *See AIG I,* 965 A.2d at 782–94.

158 *Id.* at 793–94.

159 *Id.* at 775–76. Consistent with the decision of a special litigation committee of the AIG board, AIG itself also became a plaintiff in the litigation to pursue direct claims for breach of fiduciary duty against Greenberg and another officer. *See id.* Unless otherwise noted, all claims discussed in this section pertain to the derivative aspects of the *AIG I* and *AIG II* decisions.

160 *AIG II,* 976 A.2d at 879.

161 *Id.* at 880–81.

162 *AIG I,* 965 A.2d at 776.

163 *Id.*

164 *Id.* at 795–815.

165 *AIG II,* 976 A.2d at 876.

166 *AIG I,* 965 A.2d at 818–22.

167 *Id.* at 823–30.

168 *Id.*

169 *Id.* at 822.
170 *Id.*
171 *Id.* at 828 n. 246.
172 *Teachers' Ret. Sys. of La. v. PriceWaterhouseCoopers, LLP,* 998 A.2d 280 (Del.2010).
173 15 N.Y.3d 446, 912 N.Y.S.2d 508, 938 N.E.2d 941, 945 (2010).
174 *Id.*
175 *Id.* at 882, 895.
176 *Id.* at 885–88.
177 *Id.* at 888.
178 *Id.* at 889.
179 *Id.*
180 *Id.*
181 *Id.* at 895 n. 59.
182 *See AIG II,* 976 A.2d at 883; *Berner,* 472 U.S. at 310, 105 S.Ct. 2622.
183 *See, e.g.,* Compl. ¶¶ 56, 62–70, 78, 94–95, 102, 263–66.
184 The Receiver does not seriously contend that the SPI Entities do not bear fault for their present situation, but rather advances several exceptions that she argues should apply here to preclude the Moving Defendants' *in pari delicto* defense. I address those arguments in the next sections.
185 *See supra* notes 143–146; *see also*RESTATEMENT (THIRD) OF AGENCY § 5.03 cmt. b (2006).
186 *See* RESTATEMENT (THIRD) OF AGENCY § 5.04 ("For purposes of determining a principal's legal relations with a third party, notice of a fact that an agent knows or has reason to know is not imputed to the principal if the agent acts adversely to the principal in a transaction or matter, intending to act solely for the agent's own purposes or those of another person.")
187 *AIG II,* 976 A.2d at 891.
188 *Id.*
189 *Id.* at 894.
190 *Id.* at 892–94 (holding that the traditional, narrow approach to the adverse interest exception was the correct statement of Delaware law); *see also Kirschner,* 15 N.Y.3d at 466–67, 912 N.Y.S.2d 508, 938 N.E.2d 941, 952 (noting that the traditional, narrow formulation of the adverse interest exception "avoids ambiguity where there is a benefit to both the insider and the corporation," and therefore is suitable only where the insider's misconduct benefits only himself or a third party).
191 *Cf. Kirschner,* 912 N.Y.S.2d 508, 938 N.E.2d at 953 ("Consistent with these principles, any harm from the discovery of the fraud—rather than from the fraud itself—does not bear on whether the adverse interest exception applies.... If that harm could be taken into account, a corporation would be able to ... disclaim virtually every corporate fraud—even a fraud undertaken for the corporation's benefit—as soon as it was discovered and no longer helping the company.").
192 *See Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co.,* 267 F.3d 340, 359 (3d Cir.2001).
193 *Id.* at 359–60; *see also In re Jack Greenberg, Inc.,* 212 B.R. 76, 86 (Bankr.E.D.Pa.1997).
194 *See, e.g., In re Mediators, Inc.,* 105 F.3d 822, 827 (2d Cir.1997); RESTATEMENT (THIRD) OF AGENCY § 5.04 cmt. d (2006) ("[I]f the agent controls the principal's decisionmaking, the principal is charged with notice of the agent's wrongdoing. This rule, often termed the 'sole actor doctrine,' treats principal and agent as one.").
195 Compl. ¶¶ 30, 44, 96. *See* Receiver's Answering Br. to Auditor Defs. 2–3, 42.
196 Receiver's Answering Br. to Auditor Defs. 43 (quoting *Reider v. Arthur Andersen, LLP,* 47 Conn.Supp. 202, 784 A.2d 464, 474 (2001) (refusing to use the sole actor rule to override the adverse interest exception, and allowing the state insurance commissioner to bring claims against liquidated insurer's former auditor)).
197 *Cf. Reider,* 784 A.2d at 474–75 ("Therefore, when a sole owner seeks to loot his own insurance company, every person with a legally protected interest in the insurer's continuing solvency is *not* a knowing and willing participant in the owner's fraud. Like an innocent minority shareholder whose interests in a corporation are harmed by a conspiracy of the other shareholders ... the public is an innocent stake holder in the solvency of the insurer."). This type of argument was expressly rejected in *AIG II* because it would make *in pari delicto* a dead letter. *AIG II,* 976 A.2d at 893 ("[A]n innocent insider exception, like the plaintiffs' personal interest exception, would allow corporations to sue their own co-conspirators for actions that were undertaken, at least in part, for the corporation's own interest, giving corporations rights that natural persons do not have.")
198 *AIG II* involved *in pari delicto* defenses raised by third-party co-conspirators, not auditors, and is there somewhat distinct from the claims against the Moving Defendants in this case. Nevertheless, if Delaware embraced the type of "innocent stakeholder" exception

the Receiver urges in this regard, it would gut the *in pari delicto* defense regardless of who was raising it. I address in the next Section the specific arguments regarding whether auditors should be treated differently than other defendants.

199 In addition to the holding *AIG II,* at least two other reasons support this conclusion. First, insurance companies are not the only companies that are relied on by their customers and creditors, nor are they unique in being systemically important. Because similar considerations apply to many regulated industries (*e.g.,* financial institutions, food and drug companies, utilities, railroads, and aviation, etc.), the purportedly "unique" or narrow carve-out urged here easily could sweep much of the economy within its ambit. Second, I note again that the innocent parties involved here are not without remedy. The issue again is "not whether [they] can seek relief on the corporation's behalf, but from whom [they] can seek that relief." *AIG II,* 976 A.2d at 889.

200 *AIG II,* 976 A.2d at 888 n.43 (quoting *Seacord v. Seacord,* 33 Del. 485, 139 A. 80, 81 (Del.Super.1927)).

201 *AIG II,* 976 A.2d at 889 ("According to the plaintiffs, in such situations the traditional rule is unjust because the stockholders themselves did not act wrongfully, and therefore the traditional in pari delicto rules should be set aside so that the corporation can be made whole and thus the economic interests of the innocent stockholders can be protected. But, the exceptions that the plaintiffs request would eviscerate the in pari delicto doctrine and contravene the policy judgments upon which that doctrine rests.")

202 I reject as unpersuasive the suggestion that parties like trustees or receivers should be able to avoid *in pari delicto* and similar defenses merely because they do not "voluntarily step" into the shoes of the defunct entity, but rather are "thrust into" those shoes. *See F.D.I.C. v. O'Melveny & Myers,* 61 F.3d 17, 19 (9th Cir.1995). Stockholder derivative plaintiffs are no less "thrust into" a position of having to bring suit on behalf of an entity betrayed by its fiduciaries. Further, the idea that the party raising *in pari delicto* "enjoys a windfall," *id.* misses the point of the doctrine—sparing the court from becoming entangled in claims between wrongdoers. *See* 3 POMEROY *supra* note 103, § 940 n. 5. In any case, it is not clear that *O'Melveny & Myers* stands for a proposition that is helpful to the Receiver. *See, e.g., In re Imperial Corp. of Am.,* 92 F.3d 1503, 1509 (9th Cir.1996) (clarifying that *O'Melveny* does not mean that "equitable defenses can never be asserted against FDIC acting as a receiver"); *In re Bartoni–Corsi Produce, Inc.,* 130 F.3d 857, 862 (9th Cir.1997) (clarifying that *O'Melveny* was focused on "the question of *fiduciary* liability," and finding *O'Melveny* inapposite in the context of determining whether a third party non-fiduciary is liable to a corporation) (emphasis added).

203 *See* 18 *Del. C.* §§ 101 to 8412 (the "Insurance Code"); *id.* §§ 6901 to 6983 (relating to captive insurers).

204 *See id.* §§ 301 to 333.

205 *German Alliance Ins. Co. v. Lewis,* 233 U.S. 389, 414, 34 S.Ct. 612, 58 L.Ed. 1011 (1914).

206 *Karen Weldin Stewart—Biography,* DEL. DEPT. OF INS. (last accessed Mar. 23 2015), http://www.delawareinsurance.gov/bio.shtml.

207 *See Berner,* 472 U.S. at 311, 105 S.Ct. 2622; *Pinter,* 486 U.S. at 635, 108 S.Ct. 2063.

208 *See, e.g.,* 18 *Del. C.* § 318 (Commissioner may examine any Delaware insurance company in her sole discretion); *id.* § 319 (same as to insurance agents, brokers, and the like).

209 *See, e.g., id.* § 313 (granting the Commissioner broad authority to institute proceedings through the Attorney General to enforce "any order or action" of the Commissioner, and to refer criminal violations of the insurance code to the Attorney General).

210 18 Del. Admin. C. §§ 302–2.4, 302–4.2.

211 18 *Del. C.* § 311.

212 187 N.J. 353, 901 A.2d 871, 882–83 (2006).

213 *Id.* at 885–86.

214 *Id.; see also id.* at 886 n. 3.

215 *Official Comm. of Unsecured Creditors of Allegheny Health Educ. & Research Found. v. PriceWaterhouseCoopers, LLP,* 605 Pa. 269, 989 A.2d 313 (2010) [hereinafter "*AHERF* "].

216 *Id.* at 339.

217 Receiver's Answering Br. to Auditor Defs. 37–41.

218 *AIG I,* 965 A.2d at 828 n.246.

219 *Id.*

220 *Id.; see also id.*("The even larger disproportion between independent directors fees and liability inspired § 102(b)(7) as well as the gross negligence standard Delaware corporate law applies in cases when a § 102(b)(7) clause does not apply. One can therefore understand the concern about the need to keep the auditor industry healthy, or to avoid the possibility that audit firms will suffer huge verdicts by fact-finders desirous of holding anyone they can liable for a fraud-based corporate meltdown or whose judgment about the auditor's capability to have detected the fraud through the use of professional diligence is compromised by hindsight bias.").

221 *Id.* at 821–22.

222 Depending on who their client is, for example, auditors are subject to "authoritative" standard-setting by, among others: the Federal Accounting Standards Advisory Board; the Financial Accounting Standards Board; the Governmental Accounting Standards Board; the Public Company Accounting Oversight Board ("PCAOB"); the International Accounting Standards Board; and the International

Auditing and Assurance Standards Board, in addition to the relevant boards and committees of the American Institute of CPAs, such as the Auditing Standards Board. *See Authoritative Standards,*AM. INST. OF CERTIFIED PUBLIC ACCOUNTANTS (last accessed Mar. 23, 2015), http:// www.aicpa.org/Publications/AuthoritativeStandards/Pages/AuthoritativeStandards.aspx. *See also*15 U.S.C.A. § 7211(c) (conferring upon the Securities and Exchange Commission ("SEC") the power to register and inspect public accounting firms, issue rules governing public company audits, investigate and discipline registered auditors, and otherwise "enforce compliance" with Sarbanes–Oxley, PCAOB rules, professional standards, and the federal securities laws); John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms,* 84 B.U. L.REV. 301, 336–37 (2004). This structure of audit regulation does not disappear as the focus narrows from the national level and public companies to the particular facts of this case. In Delaware, as in presumably most states, the legislature has created a State Board of Accountancy to protect the public from incompetent auditing. 24 *Del. C.* § 101. That Board has the power to develop standards assuring professional competence, monitor and adjudicate complaints brought against practitioners, promulgate rules and regulations, and impose sanctions where necessary.

223 *AIG I,* 965 A.2d at 822.

224 *Id.*

225 The elements for establishing such a claim are well known: (1) a fiduciary relationship; (2) breach of the fiduciary's duty; (3) knowing participation in the breach by the alleged aider-and-abettor; and (4) causation of damages. *Malpiede v. Townson,* 780 A.2d 1075, 1096 (Del.2001). In this regard, I note that, because of the significant overlap in their respective elements, much of the evidence for proving an aiding and abetting claim already would be coming in to prove the breach of fiduciary duty claim under the fiduciary duty carve-out to *in pari delicto.* Claims for breach of an audit contract or for professional negligence involve little or no such salutary overlap, which both reinforces the fundamental difference in the nature of the claims, and adds a practical reason for drawing this distinction.

226 *AIG II,* 976 A.2d at 879 ("[T]he plaintiffs have brought claims for fraud, conspiracy, and aiding and abetting a breach of fiduciary duty against Gen Re."); *id.* at 881 ("[T]he Complaint pleads counts of fraud and conspiracy against Marsh & McLennan, ACE, and Rivera, as well as counts of aiding and abetting a breach of fiduciary duty and unjust enrichment against Marsh.").

227 *See AIG II,* 976 A.2d at 895; *see also id.* at 895 n. 60 ("Suits against corporate agents like outside auditors are best conceived of as also within the confines of a single corporate conspirator and are consistent with the traditional acceptance of derivative suits against corporate insiders.").

228 The Complaint purports to name Kantner as a Defendant in connection with the aiding and abetting claims in Count 12. Compl. ¶ 381. As discussed above, Kantner owes fiduciary duties to the SPI Entities by reason of his position as a director, and is accused of breaching those duties. Any conduct of Kantner's that conceivably might rise to the level of aiding and abetting a breach of fiduciary duty in this regard would simply be a further breach of Kantner's own duties. Accordingly, Count 12 is dismissed as to Kantner. *See, e.g., Gilbert v. El Paso Co.,* 490 A.2d 1050, 1057 (Del. Ch.1984), *aff'd,*575 A.2d 1131 (Del.1990); *Penn Mart Realty Co. v. Becker,* 298 A.2d 349, 351 (Del. Ch.1972); *see also Higher Educ. Mgmt. Gp., Inc. v. Mathews,* 2014 WL 5573325, at *13 (Del. Ch. Nov. 3, 2014).

229 *Malpiede v. Townson,* 780 A.2d 1075, 1096 (Del.2001).

230 *Carlton Invs. v. TLC Beatrice Int'l Hldgs., Inc.,* 1995 WL 694397, at *15 (Del. Ch. Nov. 21, 1995).

231 *In re Rural Metro,* 88 A.3d 54, 99 (Del.Ch.2014).

232 *See Compl.* ¶¶ 165–175.

233 *Id.* ¶¶ 204–209. I note also that when he was briefing McSoley McCoy after they were retained for the 2009 audit, Drost said that in trying to call "Alpesh," he didn't "seem to have any success getting through, or even getting an opportunity to leave a message." *Id.* ¶ 287. That was in May 2010. After two full years of communicating with "Alpesh," Drost still had a hard time getting in touch with him. Drawing all inferences in favor of the Receiver on the pending motions to dismiss, I cannot rule out the possibility that, on the facts alleged, she could show that Wilmington Trust and Johnson Lambert knew that something about this was extremely suspicious.

234 *Rural Metro,* 88 A.3d at 97–100.

235 Count 11 also accuses Defendants James M. Jackson, King, and Davis of breaching their fiduciary duties. As those Defendants are not before me on the pending motions to dismiss, Count 11 is not dismissed as it relates to them.

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