Managing Professional Liability Litigation Against Accounting Firms (Part 1)

By Mitchell Bryan and Russell I. Shapiro

This is Part 1 of a three-part series discussing the basic components of a professional liability lawsuit brought against an accounting firm and its partners, and the factors a firm's managing partner should consider before and during this type of litigation for utilizing applicable insurance coverage, maximizing effectiveness of defense and, where possible, bringing the controversy to conclusion by settlement. Part I focuses on the current litigation environment for accounting firms, relevant provisions in engagement letters, responding to subpoenas, professional liability insurance, and the risk of instigating a professional liability counterclaim in a fee-collection action. Part 2 will cover differences between litigation in state and federal courts, and in private arbitration, initial assessment of a professional liability claim, development of defense strategy, and the stages of litigation from the initial pleadings through discovery. Part 3 will cover the latter stages of litigation from summary judgment proceedings through trial and will conclude with the mechanics of and strategies for settlement negotiation.

An unfortunate reality among accounting firm managing partners (MPs) is that at some point—if not more than once—while serving as MP, a client will sue one or more of your partners and the firm itself for professional malpractice. As primary leader of your firm, at first you will experience disbelief and denial that a client has blamed your partners and firm for a financial reporting error the client itself caused, mostly or entirely due to its own incorrect accounting entries, which normal and proper review procedures were not designed or intended to detect or correct. Once past the initial grief, anger, or both, as your firm's leader, you will need to move forward by working with lawyers that you, your firm's general counsel, or its professional liability insurer have selected to defend the claim, toward navigating the mater to resolution.

This article will aid the accounting firm MP in traversing, with the guidance of legal counsel, the typically rough terrain encountered in defending a professional liability lawsuit. Readers of this article will be able to sleep at night while dealing with this challenge, in part, because they and their firms were prepared for it well before the lawsuit was filed.

Litigation environment for accounting firms

Before looking at how you and your firm readied yourselves for the humbling, potentially devastating experience of being sued for an alleged professional error, let's briefly consider what industry analysts have been seeing in the accounting malpractice arena. This subject has been addressed by at least two research teams in recent years. In 2011, professor Ross Fuerman and his team at Suffolk University conducted a pre- and post-Sarbanes-Oxley study of 1,169 lawsuits filed from 2001 through 2008. The results showed a perceptible decrease in auditor liability risk and award size. Similarly, a 2009 study by the Ives Group reported that securities class action lawsuits against the "Big Four" firms peaked in 2003, against second-tier national audit firms in 2003 through 2007, and against third-tier regional audit firms in 2003 and 2004.

The less-encouraging news is that accounting malpractice suits persist as a byproduct of fraudulent activities by businesses and individuals in the aftermath of the recession and financial crisis. There are few major bankruptcies, liquidating receiverships, or bank failures where the failed entity, its insolvency fiduciary, creditors, or investors do not take a close look at whether a viable malpractice claim can be asserted against the defunct entity's former accountants. This type of investigation is made routinely toward tapping the accountants' professional liability insurance as a source of partial repayment of creditors.

Engagement letters

Once served or threatened with a malpractice suit, the first line of defense will be your firm's engagement letter with the client. The engagement letter should be in place long before the alleged professional error occurs. Apart from scope and reliance limitations, there are a number of key provisions your firm should include in its standard engagement letter, most of which are procedural, that may be pivotal in positioning a successful defense. One such provision is a clause requiring that any dispute relating to the engagement be resolved by binding arbitration.

Arbitration is not a complete antidote for the extraordinary expense, bad publicity, and punitive damage exposure commonly associated with lawsuits filed in state and federal courts. But, arbitration does tend to lessen these types of disadvantages of formal legal action. Although comparative advantages of arbitration over conventional litigation have been questioned in recent years, on balance, arbitration is completed faster than a lawsuit, incorporates principles of equity and fairness more so than conventional litigation, and often is more conducive to achieving pre-trial settlement.

Sometimes accompanying an arbitration clause, or in the absence of such, is a preliminary requirement that the accounting firm and former client first attempt and exhaust efforts to mediate the dispute with an independent neutral intermediary as a pre-condition to initiating arbitration or litigation. In the absence of an arbitration and/or mediation requirement, an engagement agreement should include a waiver by the client to any right it may have to a jury trial in a state or federal court lawsuit. This will help contain the otherwise time-consuming and expensive procedures associated with jury trials and also will minimize potential exposure to punitive damages more readily awarded by juries than by judges in bench trials.

The engagement letter also should include a provision requiring the client to consent to resolving any dispute in the jurisdiction where the accounting firm's main offices are located. While the engagement staff, relevant records, and other witnesses may very well be situated in a jurisdiction where the client is located, being compelled to arbitrate or litigate in the accounting firm's home territory generally places the client and its lawyers at a disadvantage. A further deterrent to a lawyer-driven or otherwise baseless claim by a former client is a provision entitling the accounting firm to recover from the former client attorney fees and all other legal expenses resulting from a dispute involving the engagement when the accounting firm is the prevailing party. Often seen as distasteful or sending the wrong message to a client at the outset of an engagement unless drafted to benefit the client reciprocally if it were to prevail in a dispute, fee-shifting provisions are too often omitted from accounting firm engagement letters.

Another provision that belongs in an engagement letter is one requiring the client to reimburse its accountants for legal fees and other expense resulting from a document or testimony subpoena seeking information involving the engagement. Litigants subpoena their opponents' accountants not only so they can serve as expert guides to financial and other details involved in business disputes, but also as a means of investigating the accountants' involvement in the preparation and review of data and in decisions underlying the dispute toward implicating the accountants. The significant cost of searching for, reviewing and assembling documents, and analyzing potential professional liability exposure can and should be borne by the client by operation of the engagement letter. While many accounting firms once hesitated to include such a provision—out of concern that the client would view it as oppressive and unfair—it is now seen in most accounting firm engagement letters.

Responding to subpoenas

Apart from whether the client or accounting firm pays for compliance, for reasons noted above, care should be taken in responding to a subpoena. Often enough, a subpoena forewarns of a possible claim against the accountants by the client or its creditors or, in some instances, a criminal indictment by a grand jury. Accountants are subpoenaed not only in civil lawsuits, arbitration, and regulatory matters involving their clients, but also in grand jury investigations targeting their client for tax fraud, racketeering, or other white collar criminal prosecution.

Judges, arbitrators, and regulatory hearing officers normally limit the scope of a nonparty subpoena more so than the scope of discovery served on a party. Such protection is invoked by timely served and properly drafted objections. Applicable procedural rules typically require the serving party to obtain a ruling on a respondent's objections to over-breadth or otherwise unduly burdensome or oppressive information requests in a subpoena. Battles over such objections can be particularly vigorous with respect to email and other electronically stored data, which can be a potent source of evidence—and which also can involve a very high cost of retrieval and prior review for privileged communications.

No different from a litigant complying with written discovery requests or deposition questions, a subpoena respondent should take precautions to avoid disclosure of written or oral privileged communications. So too should precautions be taken, by written objection followed by a stipulated or court-imposed protective order, to safeguard a subpoena respondent's trade secrets, proprietary information, or other confidential data within the scope of information sought by the subpoena. To avoid confusion between documents subpoenaed from accountants and those produced by their clients, other litigants, and other nonparty witnesses, and to facilitate orderly deposition of an accounting firm's partners or staff, all produced documents should be branded with control numbers—including a prefix identifying the subpoena respondent who produced the documents.

Professional liability insurance

An accounting firm MP should understand his or her firm's errors and omissions liability policy and its notice requirements that are a pre-condition to obtaining coverage. A professional liability policy ordinarily provides "claims made" coverage only for claims made, threatened, or apparent *and reported to the insurer* within the effective period of the policy or any agreed-upon extension of the claim reporting period after the current policy term expires. The "declarations" and "coverage forms" of such policies will state:

- primary and any excess liability coverage limits;
- amount of the deductible or self-insured retention amount the firm must pay before the insurer is obligated to start paying or reimbursing for defense costs;
- whether covered defense costs include expense of government or internal investigation;
- whether defense costs paid erode the primary coverage limit;
- whether any sub-limits, deductibles, or both apply to any special coverage (*e.g.,* for investigation costs);
- technical compliance required for notification to the insurer of an actual, threatened, or apparent potential claim (*i.e.,* circumstances the firm reasonably believes could result in a claim); and
- various exclusions that negate coverage otherwise provided under the policy.

Given that most accountant malpractice lawsuits settle before trial, perhaps the most important component of professional liability insurance is the insurer's duty to defend its insured. On certain types of claims, it is the insurer's only duty. Where coupled with a duty to indemnify for any actual liability an insured accounting firm is required to pay, an insurer's defense obligation also includes a duty to settle a claim, if possible, for a reasonable amount within the policy limits.

In performing its defense obligation, a professional liability insurer ordinarily is entitled to select defense counsel, although some policies permit the insured to do so. A conflict between the insurer and insured sometimes exists, such that the insurer must pay for independent defense counsel of the insured's own choice. Some jurisdictions recognize such a conflict and impose this obligation on the insurer when a policy exclusion may or may not apply depending on which alleged facts or which of two or more alleged theories of liability potentially could be proven at trial. When this occurs, the insurer will defend the claim under a "reservation of rights," and counsel selected by the insured accounting firm is entitled to control defense free from direction by or any attorney-client duty to the insurer.

When allowed or entitled to select its own defense counsel, the insured must pay any differential between billing rates regularly charged or specially negotiated by its attorneys and lower rates the insurer pays lawyers it routinely hires to defend claims. To comply with the insured's obligations under the "cooperation clause" found in every insurance policy, independent defense counsel must periodically report to the insurer's own in-house "claims attorney" the progress of and significant developments in the case, risk of liability at trial, any settlement demand by the plaintiff client—and any settlement offer the accounting firm proposes to make. Generally, as a pre-condition to funding settlement, the insurer must approve as reasonable any settlement proposal made by the policyholder.

Often, particularly when the insurer is defending a claim under a reservation of rights, the insurer's internal claims attorney will participate in mediation or other settlement meetings. Judges or arbitrators sometimes require such participation. In major cases, the insurer's claims attorney will attend trial toward determining whether to pursue settlement efforts before a court, jury, or arbitrator issues its decision on the merits of the claim.

Risk of counterclaim in a fee-collection action

Common sense and practical experience suggest that suing a client for unpaid professional fees substantially increases the risk of the delinquent client suing its accounting firm for professional malpractice. This must be carefully considered in deciding whether to sue a former client.

Before attempting to collect fees in court or arbitration, an accounting firm should closely scrutinize any practice issues that arose and negatively impacted the client and its relationship with the firm during the engagement. In conducting such an investigation, legal counsel should participate not only to facilitate objective evaluation of any potential professional liability, but also to insulate with attorney-client privilege what might later, in the context of litigation, be viewed as sensitive or damaging communications about professional work performed for the former client. Consideration also should be given to any financial or operating difficulties of the client that led to nonpayment of professional fees, or related disputes with third parties, which potentially could influence the client to defend a fee-collection suit by alleging that its former accountants committed professional negligence.

Against this backdrop, earnest and exhaustive settlement efforts are almost always advisable before suing a former client for unpaid fees. When a client has warned its former accountants that any legal action to collect fees will result in a counterclaim for professional negligence, consensual mediation by an independent neutral intermediary should be considered and, if appropriate, proposed to the former client as an alternative to formal legal action. Equally if not more important, any such warning should cause the firm's managing partner and legal counsel to check the firm's malpractice insurance policy to determine whether it requires the firm to give the insurer written notice of "circumstances the insured reasonably believes could lead to a covered claim"—regardless of whether a decision is ultimately made to sue for unpaid fees. Again, settlement of the fee claim should be a managing partner's primary goal. ✦

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Managing Professional Liability Litigation Against Accounting Firms (Part 2)

By Mitchell Bryan and Russell I. Shapiro

This is Part 2 of a three-part series discussing the basic components of a professional liability lawsuit brought against an accounting firm and its partners and the factors a firm's managing partner should take into consideration before and during this type of litigation for utilizing applicable insurance coverage, maximizing effectiveness of defense and, where possible, bringing the controversy to conclusion by settlement. Part 1 covered the current litigation environment for accounting firms, relevant provisions in engagement letters, responding to subpoenas, professional liability insurance, and the risk of instigating a professional liability counterclaim in a fee-collection action. Part 2 focuses on the differences between litigation in state and federal courts and in private arbitration, initial assessment of a professional liability claim, development of defense strategy, and the stages of litigation from the initial pleadings through discovery. Part 3 will discuss the latter stages of litigation from summary judgment proceedings through trial and will conclude with the mechanics of and strategies for settlement negotiation.

Defense of a professional liability lawsuit

As seen in Part 1 of this series, a number of pre-suit measures and decisions can significantly affect whether and how an accounting firm is positioned for defending a professional malpractice suit. Your firm's preparedness to defend a malpractice claim is put to the test, of course, only upon failure to resolve a controversy with a former client or one or more of its creditors through alternative dispute resolution efforts. At that point, in addition to complying with reporting obligations to primary and any excess insurers, a careful assessment must be made of any procedural options that are available only if invoked at the outset of a lawsuit, electronic and printed document preservation obligations, and substantive defense strategies that are implemented through pre-trial motion practice and discovery. Since most professional liability suits are settled before trial, the pre-trial stages of litigation discussed below ordinarily will drive the outcome of a lawsuit against your firm.

State court vs. federal court vs. arbitration

After being served with a professional liability complaint in a state or federal court action, where contractually agreed or otherwise legally permitted, it can sometimes be advantageous to transfer the case to a different court or to arbitration. Whether this is possible and advisable is a matter to be addressed by defense counsel for evaluation on a case-by-case basis. Where an accounting firm and its client agreed to resolve disputes by arbitration, assuming they do not mutually or by acquiescence decide to waive their separate right to arbitrate, action to enforce that right must be taken at the very first opportunity to avoid a waiver.

Trial attorneys often feel that a federal court lawsuit is more rigorous and quickly completed, more expensive, and more reliable than in state court, due to the presence of highly qualified judges and law clerks. Such generalizations are understandable, although not universally accurate, and can be useful only when verified in a particular jurisdiction. Even if an engagement letter fixes venue exclusively in a federal court where the accounting firm or its client are located, a state court complaint can be transferred to federal court only if federal subject matter or "diversity of citizenship" jurisdiction exists. The former requires assertion of a claim under federal law, while the latter requires that all plaintiffs as a group, and all defendants as a group, be citizens of different states with an amount in controversy of at least $75,000.

Where federal question or diversity jurisdiction exists in a case filed in a state court, within 30 days after service of the complaint an accounting firm defendant is entitled to "remove" the case to a federal court in the geographic district where the complaint was originally filed. Absent an exclusive venue provision in an engagement letter, regardless of whether the lawsuit was filed in state or federal court, or removed to federal court, statutory venue rules or common law principles sometimes will enable a defendant accounting firm to obtain a transfer of the case to a more appropriate jurisdiction. By statute in federal court lawsuits, or in state court cases under the doctrine of *forum non conveniens*, such a transfer can be accomplished only when most or all witnesses reside or work, and most or all documentary or other evidence is located, in a jurisdiction other than the one where the plaintiff filed the lawsuit.

Initial assessment of claim and development of defense strategy

After absorbing the initial impact of being sued for professional malpractice, a sober look at the lawsuit must be taken with defense counsel to develop realistic goals and expectations in defending the suit and navigating it to an acceptable outcome. At the outset, it ordinarily is not possible to determine whether the claim can be defeated. The ability to defeat the claim will depend on defense counsel first gaining an understanding of applicable accounting principles, auditing standards, and/or any AICPA practice guidance viewed in the light of the standard of professional care applicable in the state jurisdiction whose law governs your firm's relationship with its clients. It also will depend on defense counsel's ability, assisted by professionals in charge and otherwise working on the engagement, to assemble evidence and witness testimony showing, convincingly, that those individuals in all respects exercised the applicable standard of professional care in performing the engagement.

An additional, critical component of defending and defeating the claim will be securing testimony of one or more qualified and capable expert witnesses who can explain to the trier of fact how and why the defendant professionals exercised the requisite level of care in performing the engagement. *A common mistake in defending an accounting malpractice suit is waiting until pre-trial discovery is well underway before engaging an expert witness on the accounting, auditing, or other professional standard compliance issues in the case*. While this generally results from a misguided effort to defer all but unavoidable defense costs, it also wastes a valuable early opportunity to assess the strength and target weak spots in the plaintiff's liability and/or damages theory for purposes of planning focus and strategy of fact development through pre-trial discovery and independent investigation by defense counsel.

To effectively develop initial goals and expectations in a cost- and time-efficient manner as early in the case as possible, defense counsel must identify the critical legal and factual issues that will drive the outcome of the case. The key concept here is isolating the "critical" issues. It is only by first identifying the specific professional accounting standards that were central to performing the engagement that defense counsel can pinpoint whose and what actions, omissions, and documentation will bear on whether the professionals met those standards and whether the acts, omissions, or other conduct of the client or others were the primary cause of the accounting or financial reporting inaccuracy or error that resulted in the clients' or its creditors' financial loss. This process will enable defense counsel to develop a plan for investigating, collecting, and organizing witness testimony and documentary evidence to build a concise, coherent story explaining your firm's side of the case.

Early on in the case, your firm's professional liability insurer will want defense counsel to prepare an initial litigation budget to ball-park defense costs the insurer will incur during each stage of the case and whether the projected defense work and resulting fees appear proportionate to the complexity and scale of the case. From the perspective of a defendant accounting firm and its partners, where their professional liability indemnity coverage limit is eroded by defense costs, the initial and periodically updated litigation budget is important for the firm's leadership to understand whether and how quickly the indemnity coverage limit will be depleted or exhausted before settlement efforts are likely to occur. If a malpractice lawsuit seeks $10 million, the initial litigation budget is $1.5 million, and the primary and excess policy coverage limits respectively are $1 million and $2 million, the remaining $1 million coverage limit may not be enough to fund the entire settlement. In the event of an opportunity to settle for $5 million, for example, the CPA firm partners would have to pay the $3.5 million differential. As every dollar paid for defense costs will increase the partners' exposure, containing defense costs throughout the case will be a common objective of the insurer and its insureds alike.

In any event, and particularly where defense costs erode the indemnity coverage limit under applicable insurance, consideration should be given early on in the case to settlement efforts through mediation or otherwise. Valuation of the claim for settlement purposes can be done effectively by both sides only after thorough initial assessment of the claim, making such an assessment that much more important. Since a defendant accounting firm will have more access to material evidence early on in the case, effective early settlement efforts often require informal information and document exchange with the plaintiff preliminary to formal pre-trial discovery. Depending on counsel's view of the most effective defense strategy, if early settlement efforts fail, an early exchange of evidence and expected witness testimony often is useful toward focus and efficiency in pre-trial discovery to follow. Caution: early settlement efforts must be approved and coordinated with the accounting firm's professional liability insurer.

Stages of litigation

Similar to most other types of lawsuits, malpractice actions typically progress in discrete stages, starting with the original complaint and continuing through trial failing settlement beforehand, and sometimes continuing on through an appeal.

Pleadings and motions on the pleadings. The complaint ordinarily will allege facts common to all counts, followed by multiple counts stating alternative theories of liability (*e.g.,* negligence or breach of contract). Where the plaintiff claims its former accountants violated more than one accounting principle or standard, each such violation is likely to be asserted in a separate count. Generally within 30 to 60 days after service of the complaint, a response must be filed with the court in the form of a motion to dismiss one or more of the counts and/or an answer admitting, denying, or asserting a lack of knowledge of the truth or falsity of each discrete allegation in each count as to which dismissal has not been sought.

The most common basis for seeking dismissal of a given count is that the complaint's allegations, even if proven, would not establish grounds for liability or recovery. Other types of motions on the pleadings are: (1) motions for a more definite statement of the claim; (2) motions to strike particular allegations; and (3) motions for judgment on the pleadings (after an answer has been filed, where it is apparent from the admissions and denials that a party is entitled to judgment as a matter of law). When answering instead of seeking dismissal, in addition to any affirmative comments included as part of any particular admission or denial, the answer also will include a variety of "affirmative defenses." Proof of allegations in a properly stated affirmative defense (*e.g.,* expiration of the statute of limitations, contributory negligence, lack of contractual privity, or lack of reasonable reliance on the accountant's work) would, if proven, defeat the claim even if the plaintiff's material allegations are true.

Pre-trial discovery. As the typical professional liability lawsuit will (and should) settle before trial, the most grueling, aggravating, and expensive stage of litigation—from the perspective of the accounting firm—is pre-trial discovery. In discovery, the parties exchange evidence and witness testimony, and obtain the same from nonparties, to develop evidence for trial and determine what fact issues are contested and require determination by trial. Judges have discretion to stay discovery until denial of a motion seeking dismissal of an entire complaint and typically will enter a discovery scheduling order soon after an answer to one or more counts of the complaint has been filed. Toward determining a manageable timetable for completing discovery, the court ordinarily will require the parties' lawyers to meet, confer, and jointly submit a proposed discovery schedule. In any given professional liability case, discovery can continue for anywhere from six to 60 months, although 12 to 24 months is the norm.

Parties in a case engage in discovery by written requests or notices that call for production of documents, answers to written questions, and appearance of party-controlled witnesses for oral deposition. Discovery is obtained from nonparties by subpoenas requiring document production, oral testimony, or both. Discovery of electronically stored information (ESI), such as email, proprietary databases, and social media accounts, is often problematic and requires close supervision by the trial court judge because of the broad scale of information and sometimes extraordinary cost of compliance involved.

Methods of cost- and time-effectively managing discovery of ESI and how courts address substantial problems and disputes between the parties that arise relative to discovery of ESI is a topic of numerous published judicial decisions and professional commentary beyond the scope of this article. A commonly addressed issue in this context is whether a party has adequately preserved its ESI by establishing and following its own internal ESI preservation and destruction policies. While failure to do so can result in serious evidentiary consequences to the offending party, more so than most, litigant accounting firms are typically vigilant in preserving their ESI and ordinarily do not encounter serious problems in this aspect of defending a malpractice claim.

Deposition of fact witnesses generally is the most critical stage of discovery. Apart from testing the credibility of the accounting firm's factual account of what happened, fact witness depositions are the proving ground for determining which relatively small subset of often thousands of documents will, at trial, shed the most light on the major issues at hand. Typically, after deposition of fact witnesses is completed, the parties will exchange reports prepared by their respective experts whose depositions then will be taken by the opposing party to test the validity of opinions to which each expert plans to testify at trial. Sometimes before, but more often after completion of fact discovery, the parties will complete discovery by written requests for admission of specific facts, which the requesting party feels are not genuinely in dispute. To the extent such admissions are obtained, the admitted facts are submitted to the judge or jury at trial as true and need not be proven by evidence and/or witness testimony. Facts so admitted in discovery also can be a very powerful tool for defeating a professional malpractice claim without going through the ordeal, expense, and risk of trial—by means of summary judgment proceedings, which will be the lead-off topic in the final segment of this three-part series.

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Managing Professional Liability Litigation Against Accounting Firms (Part 3)

By Mitchell Bryan and Russell I. Shapiro

This is Part 3 of a three-part series discussing the basic components of a professional liability lawsuit brought against an accounting firm and its partners and factors a firm's managing partner should consider before and during this type of litigation for utilizing applicable insurance coverage, maximizing effectiveness of defense and, where possible, bringing the controversy to conclusion by settlement. Part 1 covered the current litigation environment for accounting firms, relevant provisions in engagement letters, responding to subpoenas, professional liability insurance, and the risk of instigating a professional liability counterclaim in a fee collection action. Part 2 focused on differences between litigation in state and federal courts, and in private arbitration, initial assessment of a professional liability claim, development of defense strategy, and the stages of litigation from the initial pleadings through discovery. Part 3 discusses the latter stages of litigation from summary judgment proceedings through trial and will conclude with the mechanics of and strategies for settlement negotiation.

Bringing the lawsuit to a conclusion

Having completed most or all of pretrial discovery, with input from the accounting firm's managing partner and the professional liability insurer's claim attorney, the lead defense attorney must make a critical strategic decision toward bringing the litigation to conclusion. At this point in the case, based on the strength of evidence, fact and expert witness testimony, and law supporting the accounting firm's defense, a determination must be made by defense counsel, the firm, and its insurer whether to seek full or partial summary judgment and/or pursue settlement efforts in earnest toward avoiding the risk of or positioning for resolution through a bench or jury trial. The following final segment of this article will aid the firm's managing partner in understanding the components, decisions, and strategies involved in the latter and final stages of a malpractice lawsuit.

Summary judgment

As fact and expert discovery approach completion, a critical and usually difficult strategic decision defense counsel and the professional liability insurer must make is whether to seek summary judgment either on a case dispositive issue or on one or more subsidiary fact or legal issues, the resolution of which could significantly affect the outcome of the case either at trial or through settlement. In technical terms, a party is entitled to summary judgment when in respect to one or more claims or underlying fact or legal issues, there is no genuine dispute about any material fact relating to the claim or issue and, based on undisputed material facts, one of the parties is entitled to judgment as a matter of law. In practical terms, this means a party is entitled to a final, appealable ruling in their favor on a claim or underlying issues based on admissions in the pleadings and other evidentiary materials, such as uncontested documentation, the parties' answers to written questions, affidavits, deposition testimony, and responses to requests for fact admissions—without the need for determination at trial. This amounts to a trial on paper of all or part of the dispute, rather than through an evidentiary hearing in the courtroom.

In part because summary judgment effectively deprives the losing party an opportunity to have their case heard and decided by trial, in cases involving any significant degree of factual or legal complexity (such as a professional liability action), summary judgment is infrequently granted. In many types of cases, summary judgment is inappropriate simply because one or more essential elements of a claim, such as whether an accountant's conduct met the applicable standard of care, traditionally are recognized as factual issues that by their very nature can be determined only through trial and not summarily. Yet despite the odds against obtaining summary judgment, deciding whether to seek such a ruling presents a difficult strategic decision.

Occasionally, when the outcome of a professional liability lawsuit turns on a contested legal issue, resolution of such an issue can be efficiently and cost effectively determined on a summary judgment motion. This type of issue sometimes can and is decided at an earlier stage of the case either by a motion to dismiss, or a motion for judgment on the pleadings, in respect to one or more claims alleged in the original or an amended complaint. Since a full or partial summary judgment motion ordinarily involves displaying the defense's plan of proof, when the outcome of a malpractice claim turns on proof of one or more facts that the plaintiff contends are genuinely in dispute, defense counsel must make a strategic decision whether to tip their hand, educate the plaintiff, and effectively commit to a battle plan well before trial on the low-odds chance of knocking-out the entirety or even an important part of the plaintiff's case. Another significant factor the accounting firm's insurer will consider before authorizing defense counsel to prepare and file a summary judgment motion is the substantial cost ordinarily involved in preparing this type of "evidentiary" motion and supporting briefs, as well as preparing for and arguing the motion before the court.

Yet summary judgment motions are frequently filed in professional liability suits, either in respect to the entire case or particular issues, for a couple of very important strategic reasons. First, apart from the possibility of defeating the lawsuit or a critical element of the plaintiff's claim without the expense, time commitment, and risk of going to trial, placing the plaintiff at serious risk of the accounting firm summarily defeating or crippling the lawsuit very often creates enough leverage to bring the dispute to conclusion by settlement before the court rules on the motion. Second, even where a summary judgment motion fails to produce settlement, the opportunity to preview the defense's evidence, testimony, and strategy to the trial court judge can be an important and instrumental opportunity to educate the judge about key and/or complex components of the defense case that ultimately can affect how the judge rules on evidentiary, other procedural matters such as motions to exclude certain types of evidence, and acceptance of proposed jury instructions right before and during trial. As much as any other aspect of professional liability litigation, summary judgment motions can be very powerful tools.

Offer of judgment

Another tool that can be quite powerful in professional negligence cases that were brought in federal court or states that directly or effectively adopt the Federal Rules of Civil Procedure is a procedure known as an "offer of judgment." This procedure allows a defendant accounting firm to offer the plaintiff a consent judgment in a specific dollar amount, whereby if the plaintiff fails to prove liability and obtain a judgment at trial (or by an order granting a summary judgment motion filed by the plaintiff) in an amount equal to or greater than the amount of the judgment offered, the plaintiff must pay the defendant's out-of-pocket costs (not including attorney fees) incurred after the offer was rejected. In such jurisdictions, a plaintiff likewise can make an offer of judgment that if rejected, will result in a costs award to the plaintiff if the outcome at trial or by summary judgment is greater than the amount of the proposed consent judgment. In some jurisdictions that adopt this procedure, the threshold case result triggering an award in favor of the party offering a consent judgment is lower than the amount of the consent judgment so offered (*e.g.*, 80 percent if the offeror is a defendant, or 120 percent if the offeree is a plaintiff). While offers of judgment seem to be underutilized in jurisdictions where this procedure is available, their use is often quite effective in producing settlement by consent judgment.

Trial

Only a small percentage of professional liability lawsuits cannot be settled or disposed of by dismissal of the pleadings, judgment on the pleadings, or summary judgment, and thus proceed to trial. The very act of a trial court judge setting a case for trial, particularly as the trial date starts approaching, can serve as a catalyst for settlement efforts. Nevertheless, once the court sets a trial date, a variety of matters must be attended to by defense counsel toward preparing for trial.

By a certain date prior to the trial, the parties ordinarily will be required to exchange trial briefs, lists of exhibits each party may use, lists of fact and expert witnesses each side may call, and any motions seeking to exclude or limit introduction of exhibits and/or witness testimony. This type of motion, called an *in limine* (latin for "at the threshold"), like a partial summary judgment motion, often serves as a powerful strategic weapon, in that blocking an opponent's introduction of evidence or witness testimony at trial based on a preliminary evidentiary ruling can, in some situations, cripple an opponent's ability to prove the required elements of the opponent's claim. Where a trial will be heard and decided by a jury, the trial court judge often will require the lawyers for both sides to exchange and submit to the court proposed jury instructions for the judge to consider before and upon hearing argument of counsel at a jury instruction conference at the close of evidence and before the jury orally and in writing receives from the judge the final set of instructions right before jury deliberation.

Several weeks before the trial date, in addition to preparing the foregoing submissions, the attorneys for both sides must schedule their respective witnesses to appear at trial and must subpoena any and all other witnesses not under their control or otherwise cooperating. Similarly, the trial attorneys must schedule their respective expert witnesses to appear and prepare them to testify to their conclusions, opinions, and underlying reasons at trial. In addition to their respective opening statements, the trial attorneys must also prepare direct examination of their own witnesses, cross-examination of their opponent's witnesses first in the plaintiff's "case in chief," next in the "defense case," and finally the plaintiff's "rebuttal case" during the course of trial. While prior to trial plaintiff's and defense attorneys alike often preliminarily prepare their closing statements, invariably the attorneys must adjust and refine their closing statements to conform to evidence and testimony the parties introduced and the trial court judge admitted into evidence during the course of the trial.

These various components of preparing for trial involve extraordinary preparation time not only by the trial attorneys but also by the accountants involved in the underlying engagement and other fact and expert witnesses. But as we know, the theater and drama of scripts prepared for the trial of professional liability lawsuits infrequently take the stage, which leads us to the final topic of this article.

Settlement negotiation and agreements

As one's journey through the foregoing review of managing defense of a professional liability lawsuit suggests, an accounting firm managing partner's goal—as well as that of the accounting firm's errors and omissions liability insurer—in all but the weakest of such cases, is to settle the claim as quickly and inexpensively as possible. This entails the following initiatives during the course of defending the lawsuit:

- targeting particular stages of the litigation for settlement discussion opportunity;
- evaluating litigation strategy options as an investment in the overall effort to position the case for settlement;
- creating the maximum risk of defeat possible for adversaries in the lawsuit (and sometimes for co-defendants as to whom contribution liability may be sought);
- engaging highly qualified experts to provide alternative liability and damages theories to facilitate evaluation of liability exposure and settlement scenario alternatives;
- convening one or more focus groups of disinterested participants (mock jurors of sorts) to listen to, digest, and evaluate the merits of the plaintiff's case and the accounting firm's defense(s); and
- painting for the accounting firm's professional liability insurer, in confidential and privileged communications, as dark a picture as possible of potential liability exposure to motivate the insurer to adequately fund settlement.

Ultimately, a defendant accounting firm's settlement negotiations may be as much an exercise between itself and its professional liability insurer, as between itself and the plaintiff. The insurer's claim attorney or other representative thus often will wish or be required to participate in voluntary or court-ordered mediation or at a pre-trial settlement conference with the trial court judge. Throughout the litigation, to comply with the accounting firm's duty to cooperate with its insurer, defense counsel must periodically report to the insurer status, progress, strategy, and settlement efforts in a timely and accurate manner. Yet in doing so, regardless of their confidence about defeating the plaintiff former client's or third-party creditor's claims, defense counsel must be careful not to over-state their confidence to leave the insurer concerned with its own potential indemnity coverage exposure, in order to motivate settlement funding sufficient to bring the dispute to conclusion.

Considering that most accounting malpractice suits are resolved by settlement, this article would be incomplete without suggesting a few concepts and techniques for effectively negotiating settlement. First, among the defense lawyers, select a lead negotiator or co-lead negotiators who have not been in the trenches of day-to-day litigation combat and who are not emotionally tied to proving the accounting firm's defenses or the outcome of the lawsuit. Second, during the progression of settlement discussions, reserve ammunition to overcome potential impasses and arrive at mutually acceptable terms. This is not merely a matter of holding back a portion of settlement funds authorized by the accounting firms' insurer; it also entails saving a piece or two of critical evidence to share with the plaintiff until settlement efforts seemingly have become derailed. An unexpected bullet heading right at the plaintiff often puts settlement talks right back on track.

Third, the negotiating technique of "bracketing" can be very effective if used at the right time. "Bracketing" means responding to a settlement demand with a proposition to one's opponent that a counter-proposal will be made at a certain amount if, and only if, the opponent's next counter-proposal is at a specified amount, creating a smaller but more bridgeable gap in settlement positions than that existing at the time of the bracketing proposal. This technique is often helpful in breaking an impasse where settlement positions are too far apart, and neither side is inclined to believe that a compromise middle ground can be achieved. The smaller, bracketed gap is usually indicative of a likely target settlement figure finishing point—particularly when the bracket proposal is accompanied by some indication as to whether the party making the proposal has a view toward meeting their opponent in the vicinity of the mid-point of the bracket.

Fourth, the old adage "silence is golden" sometimes can be very powerful in settlement negotiations. In other words, after deciding what unacceptable dollar amount should be counter-offered at a given point in settlement talks, making one's opponent wait for some period of time—ideally, an uncomfortably long time, can create an increased degree of anticipation and apprehension in one's adversary. Often enough, such a delayed communication of a counter-offer is met with unpleasant or angry recoil that then stimulates a further—and perhaps final—counteroffer that might have otherwise never come.

Further, another time-worn adage worth remembering is "a bad settlement is better than a good case." This should be self-explanatory and is simply a reminder that certainty of a manageable settlement is almost always more prudent than gambling on an uncertain, and potentially devastating, outcome at trial. The many uncertain and pivotal moments at a trial of a complex and/or large-scale lawsuit like a professional liability action are the reason that the outcome at trial of a "winnable" defense of an accounting malpractice case can be unfortunate.

Finally, yet one more adage: "time is money" often seals the deal in settlement negotiations. Plaintiff's attorneys and professional liability insurers alike recognize the time value of money and how this concept can be employed to reach terms of a structured or deferred payment settlement where other monetary alternatives would be unacceptable. As with other settlement negotiating techniques, successful use of this one often is a matter of timing. Typically, suggesting deferred payments is best left to the very end of negotiations, where settlement funding from an insurer has been exhausted and a final concession from the plaintiff is needed to reach mutually acceptable terms.

Conclusion

Managing partners of accounting firms know all too well that a professional negligence lawsuit brought by a former client or creditors of an insolvent former client is likely to happen sooner or later in the ordinary course of the firm's business and development. As with other aspects of managing a professional service firm, the fact of this type of unpleasant, disruptive, and expensive ordeal is not as significant as the process and perspective a managing partner must follow and maintain in addressing the matter and bringing it to resolution in a way that protects the firm's core assets, values, and productive focus. Understanding the various moving parts, procedure- and lawyer-driven aspects of and tools for defending and if possible settling a professional negligence suit, should be part of the skill-set of every accounting firm managing partner. A thorough review of the litigation process and concepts discussed in this article should aid accounting firm leadership in acquiring this important skill set.

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