Managing Professional Liability Litigation Against Accounting Firms

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Part III of III

This is Part III 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 I 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 II 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 III 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.

Resources:
How Small Firms Can Balance Engagement Risk and Client Expectations While Having Adequate Resources

Engagement Risk and Acceptance

Risk Assessment Plans for the Future

Approaches to Mitigating Risk

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 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 tar- get 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 timeworn 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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