SUPREME COURT OF FLORIDA

No. 96,413

KPMG PEAT MARWICK, etc.,

Petitioner,

vs.

NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PENNSYLVANIA, etc.,

Respondent.

BRIEF OF AMICUS CURIAE THE SURETY ASSOCIATION OF AMERICA

On Review of a Decision of the District Court of Appeal of Florida, Third District

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CERTIFICATE OF TYPE STYLE

We certify that we have used 14-point proportionally spaced CG Times type in this brief.

INTRODUCTION

For sixty-five years it has been the law of this State that an "insurer has the right to be subrogated pro tanto to any right of action which the insured may have had against [its accountants], whose alleged wrongful act or negligence caused the loss . . . ." *Dantzler Lumber and Export Co. v. Columbia Cas. Co.*, 115 Fla. 541, 556, 156 So. 116, 121 (1934). And, although the obvious concomitant was not then stated, the district court of appeal did so below with the straightforward declaration: "If a subrogation claim may proceed, we take this as persuasive that an assignment claim may likewise proceed." *National Union Fire Ins. Co. v. KPMG Peat Marwick*, No. 98-3051, slip op. 7, 24 Fla. L. Weekly D1756, D1757 (Fla. July 28, 1999). And with this same reliance on *Dantzler*, the district court concluded that National Union, the fidelity bond insurer of BankAtlantic, having paid BankAtlantic $18 million for losses incurred, could as BankAtlantic's subrogee and assignee sue the bank's independent auditor, KPMG Peat Marwick, for professional malpractice allegedly causing the loss. Having so concluded, the district court certified to this Court the question whether *Dantzler*, undisturbed and relied on all these years, "is still good law." *National Union*, slip op. at 7.

SUMMARY OF ARGUMENT

As an amicus curiae in this matter,[1] The Surety Association of America ("SAA") will address three points. We will explain, first, that fidelity insurers inquire about and rely on audited financial statements of their prospective insureds in underwriting the risk to be assumed under their insurance policies; second, that the statistics on which premiums for such coverages are ultimately based are computed from historical net losses, that is, losses paid less recoveries received; and third, that the position advocated by KPMG would adversely affect the public interest in that it would increase the cost of required fidelity insurance, and therefore the cost of operating a bank, and it would shift the loss caused by the negligence of a bank's accountant from the party in a position to have prevented it, in this case KPMG, onto a party that could not have prevented it, National Union. If KPMG can shift the loss caused by its negligence onto someone else's insurance, it has no financial incentive to incur the costs necessary to help reduce the incidence of fraud. This Court's decision in *Dantzler* prevents that shift, and should be adhered to as being as much in step with modern-day tort law as it was when it was first decided.

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[1] The Surety Association of America has simultaneously filed its motion for leave to appear as amicus curiae with the written consents of the petitioner and respondent. Although, because consented-to, the motion for leave may be unnecessary under Florida Rule of Appellate Procedure 9.370, we believed it to be the safer practice to file it.

STATEMENT OF THE ROLE OF THE AMICUS CURIAE, THE SURETY ASSOCIATION OF AMERICA

Commercial banks are required to have insurance coverage under a financial institution bond. The standard form of this bond is Standard Form No. 24 of The Surety Association of America (SAA), which is filed with the insurance department of each state, including Florida.[2] SAA also prepares and files Form SA 5874f (revised to December 1993), the Application for Standard Form No. 24, the bond.[3]

Pertinent here is Section 11 of that application, which asks the applicant bank for the following information concerning its audit procedures:

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[2] The decision in this case will impact all banks and fidelity insurers in Florida, and our amicus brief addresses the standard forms approved by the Florida Department of Insurance. SAA member companies, including the petitioner, National Union, are free to file their own forms and applications, and often do. These specific company forms are usually based on the appropriate SAA Standard Form with relatively minor variations.

[3] Form SA 5874f was approved by the Florida Department of Insurance on January 10, 1994. For the Court's convenience we have attached a copy of this application (Appendix, A1-A4).

11. AUDIT PROCEDURES:

(a) Is there an annual audit by an independent CPA?.........Yes No

(b) If "Yes", is it a complete audit made in accordance with generally accepted auditing standards and so certified? ....Yes No

(c) If the answer to (b) is "No", explain the scope of the CPA's examination ____

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(d) Is the audit report rendered directly to the Board of Directors? ....Yes No

(e) Name and location of CPA ____________________________

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(f) Date of completion of the last audit by CPA _______________

(g) Is there a continuous internal audit by an Internal Audit Department?...Yes No

(h) If "Yes", are monthly reports rendered directly to the Board of Directors?..Yes No

(i) If (a) and (d) or (g) and (h) are answered affirmatively, is there direct verification of at least 20% of all deposit accounts and direct verification of at least 20% of all loan accounts?..Yes No

The information about audit procedures obtained in the Application is used to compute an increase or decrease in the premium — to be offered to the prospective insured — of as much as plus or minus 15%.[4] The insurer relies on the existence and

[4] SAA also files with each insurance department a Manual of Rules, Procedures and Classifications for Fidelity, Forgery and Surety Bonds. The manual guides the underwriting process of the member companies who use it. A part of the manual is Fidelity Rating Plans. The particular plan applicable to Financial Institution Bonds – Loss Cost Rating Plan One (LCRP-1) – provides for a premium credit or debit of up to 15% for Audit Procedures. LCRP-1 was approved by the Florida Department of Insurance on November 1, 1994. For the Court's convenience, LCRP-1 is attached (Appendix, A5-A12). Again, the SAA forms and manual are available for use by its member companies which can, however, choose to file their own variations with the insurance departments. The SAA filings are the industry standard, but their use is not

competence of the auditor in setting the premium to be charged for its Bond. Since an audit by a certified public accountant following generally acceptable auditing standards will help reduce the type of fraud losses covered by Financial Institution Bonds,[5] banks that have such audits are charged lower premiums.

Another major factor in setting premiums is, of course, loss experience. SAA compiles, and provides to its member companies and state insurance departments, rating factors based on loss experience for numerous categories of insureds. These factors, called loss costs, are computed from net losses, that is, paid losses less recoveries obtained. The ability of a fidelity insurer, through subrogation or assignment, to recover from negligent third parties who caused the loss, directly impacts the premium charged for fidelity bonds.

ARGUMENT

In the present case, National Union was paid to assume the risks of certain losses suffered by BankAtlantic; it was not paid to assume the risk of losses caused by the negligence of KPMG. KPMG presumably has its own insurance and pays premiums based on losses resulting from the negligence of KPMG and other accounting firms. If the Court were to depart from *Dantzler* and make the bank's insurer bear a loss caused by the accountant's negligence, it would adversely affect the public. Plainly,

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required.

[5] See Bradford R. Carver and D.M. Studler, *The Auditor's Responsibility to Detect Fraud*, 4 Fidelity Law Association J. 89 (1998) for a discussion of the auditor's responsibilities and their potential effect on insurers.

because the net losses for Financial Institution Bonds would increase insurance premiums, these higher premiums to the bank would mean higher costs to the bank's customers.

But neither BankAtlantic nor National Union is in a position to prevent KPMG's employees from failing to perform their audit obligations, or, in other words, in a position to prevent these increased costs. KPMG is in such a position, however. Through careful hiring, training and supervision, it can reduce such losses.

One objective of the law is to reduce the incidence of loss by placing it on the party in the best position to efficiently avoid it. The "basic function of tort law is to shift the burden of loss from the injured plaintiff to one who is at fault ... or to one who is better able to bear the loss and prevent its occurrence." *Casa Clara Condominium v. Charley Toppino and Sons, Inc.*, 620 So. 2d 1244, 1246 (Fla. 1993) (citation and internal quotation marks omitted). KPMG would have little financial incentive to make expenditures in hiring, training and supervising if losses were not paid by it directly or indirectly through insurance premiums.

Further, "[i]t is a traditional function of tort law not only to provide compensation for losses, but also to ensure that careless conduct be deterred." *Sunshine Jr. Stores, Inc. v. Department of Envtl. Regulation*, 556 So. 2d 1177, 1186 (Fla. 1st DCA 1990) (Ervin, J., dissenting). The law carries out this function in many ways. *See, e.g.*, *White Constr. Co., Inc. v. DuPont*, 455 So. 2d 1026, 1029 (Fla. 1984) (rule making evidence of subsequent remedial measures inadmissible to prove negligence prevents defendant

from being penalized for preventing injury to others); *Seaboard Air Line Ry. Co. v. Parks*, 89 Fla. 405, 411, 104 So. 587, 589 (1925) (same); *Owens-Corning Fiberglas Corp. v. Ballard*, No. 92,963, 1999 WL 669026, at *3 (Fla. Aug. 26, 1999) (purpose of punitive damages is not to further compensate, but to deter similar misconduct by defendant and others in future); *Porter v. Rosenberg*, 650 So. 2d 79, 81 (Fla. 4th DCA 1995) (purpose of doctrine of strict liability is to further public safety in use of consumer goods). Thus, this Court's decision in *Dantzler* and the district court's decision under review are entirely consistent with the aspirational goals of the tort law of this State. As the brief of National Union convincingly argues, there is no compelling reason based on the accountant-client relationship to depart from *Dantzler* and the body of tort law that places loss on the party in the best position to prevent it, and by doing so, encourages the elimination of loss, and in this case, fraud. In the present case, only KPMG was in a position to prevent loss caused by its negligence in the three audits of BankAtlantic. National Union, having compensated BankAtlantic, should be allowed to go forward with its case and recover any such losses so that KPMG, and other accountants, will have an incentive to try to prevent such losses in the future.

CONCLUSION

For the reasons stated, it is in the public interest to leave the well- established rule of *Dantzler* undisturbed and affirm the well-reasoned opinion of the Third District Court of Appeal.

Respectfully submitted,

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CERTIFICATE OF SERVICE

We certify that on October _____ , 1999 we mailed a copy of this Brief of Amicus Curiae The Surety Association of America to Lewis N. Brown, Esq. and Dyanne E. Feinberg, Esq., Gilbride, Heller & Brown, P.A., Attorneys for Petitioner, One Biscayne Tower, Suite 1570, Two South Biscayne Boulevard, Miami, Florida 33131; David Wagner, Esq., Associate General Counsel for Petitioner, 280 Park Avenue, New York, New York 10017; Russell Yagel, Esq. and James F. Crowder, Jr., Esq. Kimbrell & Hamann, P.A., Attorneys for Respondent, Suite 900, Brickell Centre, 799 Brickell Plaza, Miami, Florida 33131-2805.

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