UNITED STATES DISTRICT COURT
DISTRICT OF VERMONT

MICHAEL S. PIECIAK, in his official capacity as COMMISSIONER OF THE VERMONT DEPARTMENT OF FINANCIAL REGULATION, as LIQUIDATOR of GLOBAL HAWK INSURANCE COMPANY RISK RETENTION GROUP, Plaintiff, v. CROWE LLP Defendant.	Case No. 5:21-cv-00273-gwc

LIQUIDATOR'S MEMORANDUM IN OPPOSITION TO CROWE'S MOTION TO DISMISS

The Commissioner of the Vermont Department of Financial Regulation, in his capacity as Liquidator ("Liquidator") of Global Hawk Insurance Company Risk Retention Group ("Global Hawk"), submits this memorandum in opposition to the motion to dismiss filed by Crowe LLP ("Crowe").

This is an action by the Liquidator, on behalf of Global Hawk and of its policyholders and other creditors, against Crowe for Crowe's breach of its duty of professional care in issuing audit opinions on Global Hawk's financial statements for 2016, 2017 and 2018. Each of those financial statements materially misstated Global Hawk's financial position and failed to disclose that it was insolvent. Crowe breached its duty of care both by failing to properly confirm assets with the custodian that purportedly held them and by failing to properly confirm capital contributions with the bank that purportedly received them. As a result, Global Hawk's insolvency was concealed, its liquidation delayed and its insolvency deepened, increasing the

financial loss to Global Hawk's policyholders and other creditors. If Crowe had properly sought basic confirmations, the insolvency would have been uncovered three years earlier and millions in operating losses and thefts would have been avoided.

Crowe attempts to distract from its audit failures by focusing on the misconduct of Global Hawk's President, even though its audits were to provide assurance against material misstatement "whether due to error or fraud." It also seeks to portray this as an action merely by Global Hawk's "successor," when the Liquidator has a broader statutory role in protecting policyholders and other creditors. It attempts to litigate at the motion to dismiss stage questions that are properly the subject of expert testimony and factual development, and it seeks to rely on provisions in its engagement letter that violate Vermont law and public policy. The motion to dismiss should be denied.

Allegations of the Complaint

Global Hawk is a nonstock mutual insurance company and risk retention group organized under the laws of the State of Vermont and subject to regulation by the Vermont Department of Financial Regulation ("Department"). Complaint ¶ 3.

Crowe is a public accounting, consulting and technology firm with offices around the world that, among other things, provides accounting services to public and private entities. Complaint ¶ 4. It is licensed as an accounting firm in Vermont. Complaint ¶ 4.

Crowe audited Global Hawk's financial statements for 2016, 2017 and 2018. Complaint ¶¶ 7-12. For each year, Crowe opined that – subject to a qualification concerning surplus notes – the financial statements of Global Hawk "present fairly, in all material respects, the financial position of Global Hawk," Complaint ¶¶ 15-18, and that Crowe had obtained "sufficient and appropriate" audit evidence. Complaint ¶ 13.

With each Audit Report, Crowe provided a Letter of Qualifications to Global Hawk's Board of Directors. Complaint ¶ 19. As they are referred to in the Complaint, the letters are attached as Exhibits A-C. In each, Crowe acknowledged that regulators will rely on the audited financial statements and Crowe's audit reports, and that Crowe had a responsibility to perform its audit to obtain reasonable assurance that the financials were "free of material misstatement, whether caused by error or fraud." Complaint ¶¶ 19-22. *See also* Crowe Engagement Letters at 1. Global Hawk was designated a high priority company by the Department in early 2017, and Crowe was aware of the heightened level of regulatory concern. Complaint ¶ 34.

Global Hawk's Audited Financial Statements for 2016, 2017 and 2018 materially misstated the financial condition of Global Hawk by reporting that Global Hawk was solvent when in fact it was insolvent. Complaint ¶ 23. *See* Complaint ¶¶ 73-76. The 2016 Audited Financial Statements falsely reported almost $6.6 million of capital contributions as collected when the contributions had not been made, Complaint ¶ 24, and they failed to disclose that Global Hawk and another entity had borrowed $14 million and that Global Hawk's assets were pledged to secure the loan. Complaint ¶ 27.

The Audited Financial Statements for 2017 and 2018 each falsely reported millions of non-existent cash ($18 million in 2017 and $33 million in 2018). Complaint ¶¶ 30-31. They also falsely reported millions of dollars of additional capital contributions that had not been made (almost $8.5 million in 2017 and almost $5 million in 2018), Complaint ¶¶ 25-26, and omitted the loan and pledge of approximately $14 million of Global Hawk's assets. Complaint ¶¶ 28-29.

On June 8, 2020, Global Hawk was declared insolvent and placed in liquidation by the Vermont Superior Court. Complaint ¶ 3. The Order of Liquidation appointed the Commissioner as the Liquidator of Global Hawk. Complaint ¶ 1. *See* 8 V.S.A. § 7057. The Liquidator is

authorized to institute actions to collect claims belonging to Global Hawk by the Order of Liquidation ¶ 5(a)(vii) and (xiii) and 8 V.S.A. § 7060(a)(7). Complaint ¶ 2. The Liquidator is also authorized to prosecute any action on behalf of the creditors, members, policyholders or shareholders of Global Hawk against any person by the Order of Liquidation ¶ 5(a)(xiv) and 8 V.S.A. § 7060(a)(14). Complaint ¶ 2.

As auditor for Global Hawk, Crowe had a duty to conduct its audit and issue auditor's reports with due professional care. Complaint ¶ 32; *see* Complaint ¶¶ 20-22. This included a duty to obtain sufficient and appropriate audit evidence to support its opinions. Complaint ¶ 32*;* *see* Complaint ¶ 13. It included a duty to obtain external confirmations from an appropriate confirming party, ask appropriate questions, and evaluate the reliability of the responses received. Complaint ¶ 32.

Crowe failed to conduct the audits and issue audit opinions with due professional care in two general ways. Complaint ¶ 33. First, Crowe failed to properly confirm assets held by Stifel. Crowe recognized that external confirmation of these assets was necessary. Complaint ¶ 36, 49, 59. However, in seeking confirmation of assets purportedly held by Stifel:

- Crowe failed to select an appropriate confirming party. Crowe did not seek to confirm assets asserted to be held by Stifel with the actual custodian. Instead, Crowe sought confirmation of cash and other asset amounts purportedly held by Stifel from Quantbridge, an investment advisor. Quantbridge was not the appropriate confirming party. Complaint ¶ 37, 50, 61.

- Crowe failed to ask appropriate questions. Crowe limited its confirmation inquiries to requesting brokerage statements and did not ask about liabilities and pledges respecting the assets. It did not ask about withdrawal restrictions or other accounts. Complaint ¶ 39-40, 53, 60. Crowe did not use the standard form financial institution confirmation request asking about restrictions on balances and the existence of loans, even though Crowe used that form in seeking confirmations from Global Hawk's banks as part of the same audit. Complaint ¶ 40, 53, 60.

- Crowe failed to properly evaluate whether the reponses received from Quantbridge provided reliable and sufficient audit evidence. Crowe accepted confirmations from Quantbridge that specifically disclosed that Quantbridge was not the custodian and

identified Stifel as the custodian. Complaint ¶ 38, 50. This is despite the fact that Quantbridge provided a statement from the actual custodian of other assets reported by Quantbridge. Complaint ¶ 38, 51, 62.

Second, Crowe failed to properly confirm capital contributions purportedly made by Global Hawk's founding member to increase Global Hawk's surplus position. Crowe knew the capital contributions were necessary to maintain the required level of capital in Global Hawk, and that they were to be made by Global Hawk's founding member, a company controlled by a director and officer of Global Hawk, Jasbir S. Thandi ("Thandi"). Complaint ¶ 45. It recognized the need to audit these contributions to see that they had been made. Complaint ¶ 45. But it failed to obtain sufficient and appropriate audit evidence. Complaint ¶ 45.

Crowe failed to confirm the reported capital contributions with the banks that purportedly received the deposits. Crowe instead accepted documents provided by Global Hawk. For 2016, Crowe accepted copies of the front side only of checks allegedly drawn on Thandi'a personal account and purported deposit slips from Mechanics Bank. Complaint ¶ 46. For 2017 and 2018, Crowe accepted copies of purported Mechanics Bank statements. Complaint ¶¶ 56, 66. Documents from Global Hawk itself are not sufficient or reliable confirmation of reported capital contributions purportedly made by an affiliated entity. Complaint ¶¶ 46, 56, 66.

If Crowe had properly audited Global Hawk, the insurer would have been closed in 2017 because the material misstatements in Global Hawk's financial statements and Global Hawk's insolvency would have been known. Complaint ¶¶ 42, 47, 52, 54, 58, 63, 65, 67-68. Crowe understood that the Department would rely on the Auditors Reports in regulating Global Hawk. Complaint ¶¶ 19-22, 70. The Department relied on Global Hawk's 2016, 2017 and 2018 Audited Financial Statements in its monitoring of Global Hawk's financial condition and allowing the company to continue in business. Complaint ¶ 71. If Crowe had alerted the independent members of Global Hawk's Board of Directors or the Department in 2017, 2018 or

2019 that Global Hawk was insolvent, the Department would have acted to stop Global Hawk from continuing in business. Complaint ¶ 71.[1]

By allowing Global Hawk to continue in business, the materially misstated Audited Financial Statements harmed Global Hawk by allowing it to incur operating losses and suffer misappropriations and allowing its insolvency to increase. Complaint ¶ 77. The deepening insolvency harmed Global Hawk's policyholders and other creditors, who will receive smaller distributions in Global Hawk's liquidation. Complaint ¶ 77.

ARGUMENT

Crowe moves for dismissal under Fed. R. Civ. P. 12(b)(6). "To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.' " *Ashcroft v. Iqbal,* 556 U.S. 662, 678 (2009) (quoting *Bell Atl. Corp. v. Twombly,* 550 U.S. 544, 570 (2007)). This standard is met "when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Id.* Plausibility is not akin to a probability requirement, as a court should not dismiss a claim if the factual allegations "raise a right to relief above the speculative level." *Twombly,* 550 U.S. at 555. The facts alleged here easily pass this standard.

I. The Liquidator Is Not Required To Plead Violations Of Particular Accounting Standards.

Crowe first contends that the Complaint should be dismissed because it does not allege that Crowe violated particular generally accepted accounting standards. However, it is sufficient

[1] On May 15, 2020, shortly after the Department became aware that Global Hawk's assets were materially overstated, such that the company was insolvent, the Commissioner filed an *ex parte* Petition for Seizure Order with the Court. The Court entered a Seizure Order on May 20, 2020. The Seizure Order enjoined the further transaction of business by Global Hawk without the prior written consent of the Commissioner or his designee. The Commissioner subsequently filed an Assented-to Petition for Order of Liquidation for Global Hawk with the Court on June 5, 2020, and the Court issued the Order of Liquidation on June 8, 2020. Complaint ¶ 72.

to allege, as the Liquidator has, that the accounting firm breached its duty of professional care by particular conduct. Indeed, Crowe does not cite a case on this point, and this Court has previously rejected the argument that a complaint must cite accounting standards:

> Deloitte also argues that the complaint does not cite the specific accounting standards that were violated. To hold that plaintiffs in accountant liability cases are required, prior to discovery, to cite specific accounting rules would be inconsistent with Fed. R. Civ. P. 8(a), which requires "a short and plain statement of the claim." In any case, plaintiff has alleged specific omissions in the audited financial statements. Whether these omissions constitute professional negligence is a question of fact that cannot be determined on a motion to dimiss.

Nordica USA, Inc. v. Deloitte & Touche, 839 F. Supp. 1082, 1089 (D. Vt. 1993).

The Liquidator has alleged specific acts and omissions by Crowe during its audits of the financial statements, including failing to confirm material assets with the custodian of the assets (instead of an investment advisor), failing to ask standard questions to determine whether there are liabilities and whether assets are pledged (questions Crowe asked in seeking confirmations from bank custodians), failing to properly evaluate the "confirmations" it received (which disclosed that the investment advisor was not the custodian), and accepting documents provided by Global Hawk as evidence that its controlling entity had made capital contributions instead of seeking confirmation from the bank that supposedly received them. These factual allegations raise the right to relief above the "speculative" level required by *Iqbal* and *Twombly*.

Crowe's attempt to litigate over accounting standards at the motion to dismiss stage amounts to an effort to offer expert opinion as to the applicable standards in the guise of citation, and it erroneously presupposes that formalized standards are the only measure of professional negligence. *See Kemin Indus., Inc. v. KPMG Peat Marwick LLP*, 578 N.W.2d 212, 217 (Iowa 1998); *Maduff Mortg. Corp. v. Deloitte Haskins & Sells*, 779 P.2d 1083, 1086 (Or. Ct. App. 1989). The Liquidator has alleged that Crowe failed to exercise due professional care.

"Generally, negligence by professionals is demonstrated using expert testimony to: (1) describe the proper standard of skill and care for that profession, (2) show that the defendant's conduct departed from that standard of care, and (3) show that this conduct was the proximate cause of plaintiff's harm." *Estate of Fleming v. Nicholson*, 724 A.2d 1026, 1028 (Vt. 1998). Expert testimony will assist the trier of fact in considering accounting standards, their meaning, and their application. The details of expert testimony are not required in pleadings under Fed. R. Civ. P. 8(a)(2) (requiring a "short and plain" statement of claim). The Liquidator will present expert testimony that Crowe's conduct failed to comply with the professional standard of care.

II. The Imputation and In Pari Delicto Doctrines Do Not Apply.

Crowe erroneously contends that the misconduct of Mr. Thandi must be attributed to Global Hawk and thus to the Liquidator, and that this precludes the Liquidator's claims. The Liquidator is pursuing claims to benefit the policyholders and claimants who are the preferred priority creditors in the Global Hawk liquidation. As a matter of law, the bad acts of officers or owners are not imputed to the Liquidator and do not bar the Liquidator's claims. In any event, imputation is improper under the "adverse interest" exception.

A. The Liquidator Brings This Action in the Public Interest to Protect Global Hawk's Policyholders and Other Creditors.

Crowe attempts to portray the Liquidator as a successor to Global Hawk who merely "steps into the shoes" of the company. However, the Liquidator brings this action both as the representative of Global Hawk's estate and on behalf of the policyholders and other creditors who are suffering because of Global Hawk's insolvency and consequent inability to meet its obligations. Complaint ¶¶ 2, 77. Crowe's motion disregards the Liquidator's public function.

Insurance is of great public importance. *See German Alliance Ins. Co. v. Lewis*, 233 U.S. 389, 414-415 (1914). Vermont and other states have accordingly enacted statutes regulating

insurers, *e.g.*, 8 V.S.A. ch. 101 (Insurance Companies Generally), ch. 141 (Captive Insurance Companies), ch. 142 (Risk Retention Groups), and governing their rehabilitation or liquidation. *E.g.*, 8 V.S.A. ch. 145 (Supervision, Rehabilitation, and Liquidation of Insurers).

Under the Vermont insurer liquidation statute, only a public official - the Insurance Commissioner – may be appointed as liquidator of a domestic insurer. *See* 8 V.S.A. §§ 7032(a), 7057(a). The Liquidator is to pursue claims belonging to the insurer, 8 V.S.A. §7060(a)(7), and to prosecute any action on behalf of its creditors, members, policyholders, or shareholders. 8 V.S.A. §7060(a)(14). Recovery will benefit the policyholders and claimants, not Global Hawk's owners. Under the liquidation priority statute, policyholders and claimants against policyholders are the preferred priority creditors. *See* 8 V.S.A. § 7081 ("claims under policies" are preferred Class 3 priority claims following administrative expenses). Recovery will not benefit the company's owners. *See id.* (owners fall in the lowest Class 10 priority). Global Hawk itself will ultimately be dissolved. *See* 8 V.S.A. § 7059.

The Liquidator is pursuing claims in the public interest to benefit the policyholders and other creditors who relied on the company for insurance protection and are harmed by its insolvency. The "critical goal of the liquidation process" is "the protection of the public in general and the policyholders in particular," and liquidators "are officers of the state who are required to protect policyholders, other creditors, and the public interest in the administration of an estate in liquidation." *In re Ambassador Ins. Co., Inc.*, 114 A.3d 492, 498 (Vt. 2015).

B. As a Matter of Law, the Liquidator Is Not Subject to Imputation or *In Pari Delicto* Defenses.

As described above, the Liquidator fulfills a public role and brings suit to protect the policyholders and others harmed by Global Hawk's insolvency. In this context, the bad conduct of management cannot be imputed to him to deprive the policyholders and creditors of a remedy:

> Because the Insurance Commissioner had the right and duty to take it over and manage the [company's] affairs on behalf of the public if its insolvency was threatened, the company itself had an enforceable claim against any person or entity who unlawfully contributed materially to its insolvency by violating a legal duty to advise it, either directly or through the commissioner, as to its true financial status.

McRaith v. BBO Seidman, LLP, 909 N.E.2d 310, 333 (Ill. App. Ct. 2009) (quoting *Reider v. Arthur Andersen, LLP*, 784 A.2d 464, 475 (Conn. Super. Ct. 2001)). Contrary to Crowe's assertion (Crowe Mem. 15), Crowe has obligations that go beyond Global Hawk. As a matter of Vermont law, Crowe has a duty to the Department acting for the benefit of the public, including the insurer's policyholders and other creditors. *See* Complaint ¶¶ 19-22, 70.[2]

Crowe ignores the great number of cases that have rejected imputation against an insurance commissioner as receiver because the statutory liquidator acts to vindicate the rights of the public, including policyholders and creditors. *E.g., McRaith*, 909 N.E.2d at 335 ("the imputation doctrine cannot apply to the liquidator"); *Arthur Andersen LLP v. Superior Court*, 79 Cal. Rptr.2d 879, 888-889 (Cal. Ct. App. 1998) (liquidator acts in his statutory capacity for damages done to the policyholders and other creditors and, therefore, is not subject to the imputation defense that an "ordinary receiver" may face); *Cordial v. Ernst & Young*, 483 S.E.2d 248, 256-257 (W.Va. 1996) (rejecting argument that the rights of the receiver rise no higher than those of the corporation; the receiver acts for the public, including the policyholders and creditors); *Bonhiver v. Graff*, 248 N.W.2d 291, 296-297 (Minn. 1976) (whether or not the

[2] Vermont domestic insurers are required to file annual financial statements. *See* 8 V.S.A. § 6007. This is designed to assure people "that their insurance companies shall be, and remain, not only solvent, but liquid." *In re Ambassador Ins. Co., Inc.*, 515 A.2d 1074, 1077 (Vt. 1986) (quoting *Adams v. Michigan Surety Co.,* 110 N.W.2d 677, 697 (Mich. 1961)). Vermont insurers are also required to file annual financial statements audited by an independent certified public accountant. *See* Vt. Admin. Code 4-3-52:4; Vt. Admin. Code 4-6-4:4; Vt. Admin. Code 4-6-1:3. This requirement is supposed to add the assurance of an independent professional audit to the financial statements. The accountant is required to provide a letter of qualifications. Vt. Admin. Code 4-3-52:12; Vt. Admin. Code 4-6-4:12; Vt. Admin. Code 4-6-1:3.

company would be precluded from suit, the receiver represents the rights of creditors and is not barred). *See also,* as to the liquidators role, *Taylor v. Ernst & Young, LLP*, 958 N.E.2d 1203, 1213 (Ohio 2011); *LeBlanc v. Bernard*, 554 So.2d 1378, 1381 (La. Ct. App. 1989).[3]

Federal courts in the bank context have similarly concluded that insiders' conduct may not be attributed to a receiver (the FDIC) as that would frustrate the purposes of the regulatory scheme to protect innocent third parties. *See Grant Thorton, LLP v. FDIC*, 435 Fed. App'x 188, 199-201 (4th Cir. 2011) (FDIC claims against accountants); *FDIC v. O'Melveny & Meyers*, 61 F.3d 17, 19 (9th Cir. 1995) (lawyers); *Colonial BancGroup Inc. v. Pricewaterhouse Coopers LLP*, 2017 WL 4175029 at *4-*5 (M.D. Ala. August 18, 2017) (accountants including Crowe); *Comeau v. Rupp*, 810 F. Supp. 1127, 1140-1142 (D. Kan. 1992) (accountants).[4]

As the New Jersey Supreme Court noted in a case where a company's officers made misrepresentations to it auditors (who failed to verify deposits), the accounting firm "is not a victim of the fraud in need of protection." *NCP Litigation Trust v. KPMG LLP*, 901 A.2d 871, 882 (N.J. 2006). "If [the courts] allow imputation to shield a negligent auditor from the

[3] The Liquidator's statutory role distinguishes the cases relied on by Crowe in its various "stands in the shoes" and "mere successor" arguments. Only two of the cases cited in Crowe's memorandum involved claims by an insurance commissioner as liquidator, and neither case addressed the liquidator's role in protecting policyholder interests. In *Seidman & Seidman v. Gee*, 625 So.2d 1 (Fla. Dist. Ct. App. 1992), the argument that imputation did not apply because the liquidator represented the interests of "insureds, creditors and the public generally" was first raised by an amicus on a request for rehearing. *Id*. at 4. The court held this would unfairly change the theory of recovery on which the case had been tried, and it declined to address the issue. *Id*. ("Consequently, we do not reject the argument advanced by the amicus; it is only that it is inapplicable in the present case."). In *Costle v. Fremont Indem. Co.*, 839 F. Supp. 265 (D. Vt. 1993), the liquidator sought to collect under a reinsurance contract, and the court held the liquidator was bound to arbitrate under the Federal Arbitration Act. *Id*. at 272. The case did not involve imputation, professional services or torts.

[4] Crowe's cases concerning a bankruptcy trustee's ability to bring claims on behalf of customers are beside the point. *See In re Bernard L. Madoff Inv. Sec. LLC*, 721 F.3d 54 (2d Cir. 2013), *aff'g Picard v. HSBC Bank PLC*, 454 B.R. 25 (S.D.N.Y. 2011) (concerning a trustee under the Securities Investor Protection Act). The Second Circuit noted that under that statutory scheme claims against third parties accrue to creditors, not the corporation, 721 F.3d at 63, and that the trustee cannot pursue such claims because the bankruptcy statutes do not authorize a trustee to collect claims for creditors. *Id*. at 67 (citing, *e.g.*, *Caplin v. Marine Midland Grace Trust Co. of NY*, 406 U.S. 416, 428 (1972)). Here, the Insurance Commissioner as Liquidator is expressly authorized by statute to pursue such claims. 8 V.S.A. 7060(a)(14).

consequences of its actions, we will force shareholders [here, policyholders] to shoulder the entire loss—a result that violates principles of fairness and equity." *Id*. at 887.

> An auditor's professional duty to its corporate client requires the auditor to comply with GAAS and GAAP, which are designed, at least in part, to detect fraudulent activity. Although auditors cannot be expected to catch every instance of corporate fraud, we can require that they answer to claims when they fail to detect fraud that a reasonably prudent auditor acting within the scope of its engagement would uncover.

Id. *See Thabault v. Chait*, 541 F.3d 512, 529 (3d Cir. 2008) (applying this "auditor negligence" exception to the *in pari delicto* doctrine in the insurer liquidation context).

The rationale for the *in pari delicto* doctrine "is that the wrongdoer must not be allowed to profit from his wrong." *Scholes v. Lehmann*, 56 F.3d 750, 754 (7th Cir. 1995). *See Goldberg v. Saint-Sauveur Valley Resorts, Inc.*, 2018 WL 8370060 *12 (D. Vt. Dec. 20, 2018). "The appointment of the receiver remove[s] the wrongdoer from the scene. . . . [T]he defense of *in pari delicto* loses its sting when the person who is *in pari delicto* is eliminated." *Scholes*, 56 F.3d at 754. *In pari delicto* does not apply here because, under the insurer liquidation statute, recovery would inure to the insolvent insurer's estate and the claims of policyholders and creditors have priority, such that the wrongdoers would not benefit and the innocent would be protected. *Schacht v. Brown*, 711 F.2d 1343, 1348-1349 (7th Cir. 1983). *Accord McRaith*, 909 N.E.2d at 336. *See Nicholson v. Shapiro & Assocs., LLC*, 82 N.E.3d 529, 532 (Ill. App. Ct. 2017). Crowe's imputation and *in pari delicto* arguments fail as a matter of Vermont law.

C. Imputation does not apply under the "adverse interest" exception.

Crowe's imputation argument is premature. Imputation and *in pari delicto* are fact-intensive affirmative defenses, so the better approach is to await a factual record to determine them, not to address their merits on a motion to dismiss. *See, e.g., Goldberg*, 2018 WL 8370060 at *13. If the court addresses them, and assuming they could apply to an insurer liquidator, they

do not apply because of the "adverse interest" exception. *See Mann v. Adventure Quest, Inc.*, 974 A.2d 607, 611 (Vt. 2009). Under that exception, "[w]hen an agent's interests in the subject matter are so adverse as to practically destroy the agency relationship, there is no imputation of knowledge to the principal." *Id.* at 611-612. This exception applies here because Thandi was acting contrary to the interest of Global Hawk – he was looting the company. *See* note 8.

Crowe relies on what it calls the "sole actor" exception to the adverse interest exception. Under this doctrine, "when an adverse agent is the sole representative of the principal, the principal may once again be charged with the agent's knowledge." *Mann*, 974 A.2d at 612. This doctrine does not apply here. Notwithstanding Thandi's roles, there were others who could have acted. Global Hawk's board of directors included three independent directors. Complaint ¶ 3. If Crowe had properly conducted its audit, it would have notified the board of the material misstatements, and those independent board members would have taken action. Complaint ¶ 71. As the Vermont Supreme Court recognized in *Mann*, the existence of outside directors takes the case outside the sole-representative doctrine. See *Mann*, 974 A.2d at 613 (citing and quoting *Tolz v. Proskauer Rose, LLP (In re Fuzion Techs. Group, Inc.)*, 332 B.R. 225, 239 (Bankr. S.D. Fla. 2005), as "prohibiting imputation under the sole-representative doctrine 'if there was at least one honest officer, director, shareholder, or other insider who would have taken appropriate action to rectify the wrongdoing.'").

The sole representative doctrine also does not apply because of the role of the Department. Crowe understood the Department would rely on the Auditor's Reports. Complaint ¶¶ 19-22, 70. Crowe had a duty to report material errors to the Insurance Commissioner.[5] If

[5] Auditors are required to notify the company and the Department if they determine that the company has materially misstated its financial condition. Vt. Admin. Code 4-3-52-10; Vt. Admin. Code 4-6-4:12; Vt. Admin. Code 4-6-1:6.

Crowe had reported the misstatements and Global Hawk's insolvency, the Commissioner would have stopped Global Hawk from continuing in business. Complaint ¶¶ 69, 71.

These issues were thoroughly addressed in the *McRaith* and *Reider* decisions. The courts there held that the "imputation" doctrine cannot apply where the corporate officer engaged in fraudulent conduct for the private purpose of lining his own pockets at the expense of the insurer. *See McRaith*, 909 N.E.2d at 331-333, 336. Crowe suggests that allowing Global Hawk to remain in business is not a harm to the company. As discussed below, however, continuing the insurer's operations past the point of insolvency benefits the fraudsters, not the company. *Id*. at 332-333 (discussing *Schacht*, 711 F.2d at 1348). In such circumstances, "it is unlawful, as well as illogical, to impute the agent's guilty knowledge or disloyal, predatory conduct to his corporate principal." *Id.* at 332 (quoting *Reider*, 784 A.2d at 470). Further, the courts have rejected application of the "sole owner" exception in the context of insurer liquidations in light of an insurer's unique legal obligations to policyholders and the public interest in insurance. *See id.* at 333-334 (following *Reider*). Allowing accountants to avoid liability based on *in pari delicto* and related arguments "would not serve the purpose of the doctrine – to protect the innocent." *Thabault*, 541 F.3d at 529; *NCP Litigation Trust*, 901 A.2d at 882.

III. The Complaint Adequately Alleges Causation.

Causation is a factual question for the trier of fact, not a question to be resolved on the face of the complaint. *See Estate of Sumner v. Dept. of Social and Rehab. Servs.*, 649 A.2d 1034, 1036 (Vt. 1994) ("Ordinarily, proximate cause is a jury issue 'unless the proof is so clear that reasonable minds cannot draw different conclusions or where all reasonable minds would construe the facts and circumstances one way.'") (quoting *Roberts v. State,* 514 A.2d 694, 696 (Vt. 1986)), quoting *Schaefer v. Elswood Trailer Sales,* 516 P.2d 1168, 1170 (Idaho 1973)).

Here, the complaint alleges that, if Crowe had properly done its job to audit for misstatements, whether resulting from "error or fraud," it would have uncovered Global Hawk's insolvency, Global Hawk would have been shut down, and the increased losses now being suffered by policyholders and claimants would have been prevented. That is sufficient.

Crowe contends that Thandi's fraudulent conduct "constitutes an 'efficient, intervening cause' that broke the chain of causation between Crowe's audits and the harm." Crowe Mem. at 16. Crowe's argument is backwards. It was Crowe's negligence in auditing that allowed Thandi's conduct to continue, causing harm to Global Hawk's policyholders and creditors.

The defense of efficient intervening cause requires a subsequent act that breaks the link between the defendant's negligence and the harm. To succeed under the defense, "the defendant must prove that the intervening act of another party interrupted the chain of causation connecting his or her own act to the harm." *Lexington Ins. Co. v. Rounds*, 349 F. Supp.2d 861, 867 (D. Vt. 2004) (citing *Woodcock's Adm'r v. Hallock,* 127 A. 380, 382 (Vt. 1925); *Paton v. Sawyer,* 370 A.2d 215, 217 (Vt. 1976)) (emphasis added). "An efficient, intervening cause is a new and independent force that breaks the chain of causal connection between the original wrong and the ultimate result." *Estate of Sumner*, 649 A.2d at 1036 (citing *Paton,* 370 A.2d at 217) (emphasis added). The defense does not apply where Thandi's fraud began before Crowe's negligence, and the negligence was the failure to conduct an audit that – properly conducted – would have uncovered the fraud. This is especially the case where Crowe was aware of regulatory concern. Complaint ¶ 34. *See Grant Thornton*, 435 Fed. App'x at 197-198 (management's continuing fraud is not an intervening and superseding cause).

Under Vermont law "the defendant will not be excused because of a failure to anticipate what he was bound to comprehend as a possible consequence." *Rounds*, 349 F.Supp.2d at 867

(quoting *Paton*, 370 A.2d at 217). "[I]t has long been established that an original actor can be held liable for the criminal acts of third-parties. *Id*. at 868 (citing Restatement (Second) of Torts § 448 (1965); *Sabia v. State,* 669 A.2d 1187 (Vt. 1995)).

The element of legal foreseeability is present here because Crowe was engaged to audit Global Hawk's financial statements for misstatement, "whether due to fraud or error." Complaint ¶ 32. Indeed, Crowe's Letters of Qualifications expressly noted Crowe's responsibility "to plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud." Complaint ¶¶ 20-22 (emphasis added).[6] Crowe's duty to Global Hawk (and through the Department, to its policyholders and creditors) included detecting misstatement through fraud. The fact that fraud occurred does not excuse Crowe from liability for its negligence. *See* Restatement (Second) of Torts § 449 & comment a. "The happening of the very event the likelihood of which makes the actor's conduct negligent and so subjects the actor to liability cannot relieve him from liability." *Id*., comment b.[7]

The Complaint alleges that if it had conducted its audit appropriately, Crowe would have uncovered the misstatements and notified Global Hawk's board of directors (including the independent directors) and the Commissioner, which would have resulted in Global Hawk being shut down. These allegations set forth a plausible claim that Crowe's conduct is the proximate cause of the harm. *See Thabault*, 541 F.3d at 524-525; *Colonial BancGroup Inc. v.*

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[6] Crowe's attempt to exonerate itself by citing the engagement letters (Crowe Mem. at 17) ignores these professional obligations. Holding Crowe liable does not make it an insurer against conditions outside its control; it is liable for the consequences of matters it should have, but did not, uncover and thus allowed to continue.

[7] In *Estate of Sumner*, the Vermont Supreme Court approvingly cited (on a *cf*. basis) a case where an agency's failure to obtain records and investigate was negligence that made it likely the foster child would harm others; therefore, the foster child's abuse was not an intervening cause. 649 A.2d at 1037 (citing *Haselhorst v. State*, 485 N.W.2d 180, 188 (Neb. 1992)). So here, Crowe's failure to properly seek confirmations and investigate and identify the insolvency and fraud made it likely the insolvency would increase and the fraud continue.

Pricewaterhouse Coopers LLP, 2018 WL 3454491 at *8-*9 (M.D.Ala. July 2, 2018); *Reider*, 784 A.2d at 479. Where Crowe's negligence was in failing to uncover misstatements resulting from fraud and thus permitting the fraud to continue, the continuance of the fraud is not a "new and independent" intervening act.

IV. The Liquidator Has Alleged Cognizable Damages.

The Liquidator seeks damages on behalf of Global Hawk's estate and its policyholders and other creditors. Damages include the amount by which Global Hawk's insolvency deepened due to its continued operations after it would have been shut down if Crowe had alerted the board or regulators to the material miststatements. By allowing Global Hawk to continue in business, Crowe's negligence "harmed Global Hawk by allowing it to incur operating losses and suffer misappropriations and allowing its insolvency to increase." Complaint ¶ 77. The deepening insolvency "harmed Global Hawk's policyholders and other creditors, who will receive smaller distributions on their claims in the liquidation." Complaint ¶ 77.

The Liquidator is not required to plead damages with specificity. *See* Fed. R. Civ. P. 8(a)(3) (requiring only "a demand for the relief sought"). "[I]n adjudicating a motion to dismiss, the court does not weigh the evidence or make credibility determinations." *Goldberg*, 2018 WL 8370060 at *12. It is sufficient to allege that Global Hawk's prolonged artificial solvency harmed the insurer through operating losses and misappropriations. Complaint ¶ 77.

Crowe contends that the Liquidator has not alleged "cognizable" damage because, Crowe claims, prolonging Global Hawk's existence could not harm Global Hawk. Crowe continues to disregard the role of the Liquidator in protecting policyholders, creditors and the public, but even on its own terms the argument that Global Hawk was not harmed but benefitted by the prolongation of its existence due to Thandi's conduct is absurd. As the Seventh Circuit has held:

> [T]he fact that [the insurer's] existence may have been artificially prolonged pales in comparison with the real damage allegedly inflicted by the diminution of its assets and income. Under such circumstances, the prolonged artificial solvency of [the insurer] benefitted only [the insurer's] managers and the other alleged conspirators, not the corporation.

Schacht, 711 F.2d at 1348. "A corporation is not a biological entity for which it can be presumed that any act which extends its existence is beneficial to it." *In re Inv. Funding Corp.*, 523 F. Supp. 533, 541 (S.D.N.Y. 1980). Crowe's argument "collides with common sense, for the corporate body is ineluctably damaged by the deepening of its insolvency, through increased exposure to creditor liability." *Schacht*, 711 F.2d at 1350. *Accord McRaith*, 909 N.E.2d at 332-333; *NCP*, 901 A.2d at 887-888; *Reider,* 784 A.2d at 471.

Global Hawk's continued artificial solvency allowed Thandi to misappropriate millions of dollars from the company,[8] which cannot "be described as beneficial." *Schacht*, 711 F.2d at 1348. It also allowed Global Hawk to continue to issue policies and incur increased liabilities to creditors, to its damage. *Id.* at 1350. As the Third Circuit also recognized:

> Undoubtedly, these losses, which arose from the continued writing of insurance policies, had an impact on Ambassador's solvency and increased Ambassador's liabilities. This increase in Ambassador's liabilities was caused by PwC's negligence and thus was properly considered as damages proximately caused by PwC's negligence.

Thabault, 541 F.3d at 520.[9]

[8] The Thandi complaint describes specific misappropriations: $4,500,000 paid to "Houston Management Consulting Inc." in August 2017; a net total of $3,525,497 transferred to Grey's Investment Inc. in 2018; $1,189,524 transferred to Advent Fund Ltd; and at least $10,767,157 used to pay off the SPA Loan ***7833 in 2019. Thandi Complaint ¶¶ 40, 44, 46, 27.

[9] In *Thabalt*, the court distinguished and effectively reconsidered *In re CitX Corp.*, 448 F.3d 672 (3d Cir 2006), relied on by Crowe, and held that under New Jersey law corporate damage could be found in the form of increased liabilities, decrease in fair asset value and lost profits. 541 F.3d at 521-523 (citing *NCP Litigation Trust v. KPMG*, 945 A.2d 132, 140, 142-143 (N.J. Super. Ct. Law Div. 2007)).

V. Crowe's Mere Assertions Of Material Breaches Do Not Allow It To Disclaim Its Audit Obligations.

Crowe attempts to assert as an affirmative defense to the contract counts that Global Hawk materially breached the engagement letter. In support, Crowe merely quotes the engagement letter and asserts breach. Crowe Mem. at 19-20.[10] While Crowe refers to certain paragraphs of the Thandi complaint, the conduct there alleged was not directed at Crowe or involve acts covered by the engagement letters. Further, Crowe's argument depends upon its assertion that the Liquidator is merely Global Hawk's "successor," but it cites no cases involving accountants or insurance liquidators. As discussed above, the Liquidator represents policyholder interests, Crowe understood its audit reports would be relied upon by the Department, and Crowe undertook to audit Global Hawk's financials for misstatements "whether due to error or fraud."

In this context, fraud by management is not enough to vitiate Crowe's audit obligations. If Crowe were correct, an auditor would have no reason to perform its contractual obligations to audit for misstatements due to fraud. It would never be liable for missing such misstatements because the fraud would excuse its failure to perform, rendering its contract illusory. Crowe's argument amounts to another attempt to avoid liability on grounds already addressed in the imputation and *in pari delicto* section above. The purpose of an audit is to provide assurance that financial statements are free of material misstatement. At the least, identification and careful evaluation of the claimed breaches asserted by Crowe is required, and that is not possible or proper on motion to dismiss.

[10] The contract is not just the engagement letter. The regulations requiring the audit and qualification letters (*see* note 2) are incorporated into the contract as part of the existing law. *See Merit Behavioral Care Corp. v. State Indep. Panel of Mental Health Providers*, 845 A.2d 359, 364 (Vt. 2004); *Hunter Broadcasting, Inc. v. City of Burlington*, 670 A.2d 836, 839 (Vt. 1995); *Schiro v. W.E. Gould & Co.*, 165 N.E.2d 286, 290 (Ill. 1960); *Fox v. Heimann*, 872 N.E.2d 126, 136 (Ill. App. Ct. 2007). The letters of qualification are thus also a part of the contract.

VI. The Engagement Letter Limitations Provision Does Not Bar Count VII.

Crowe contends that the contract claim regarding the 2016 audit is barred under a two year contractual limitation period in the Crowe engagement letter. This is incorrect. The Vermont Legislature has declared such provisions "null and void":

> Except as otherwise provided by statute, any provision in a contract which limits the time in which an action may be brought under the contract or which waives the statute of limitations shall be null and void.

12 V.S.A. § 465. *See Bergman v. Spruce Peak Realty*, *LLC*, 847 F. Supp.2d 653, 666-667 (D. Vt. 2012) (contractual one-year limitation "is null and void"). There is no applicable exemption.

Crowe contends that Illinois law applies to the engagement letter contract and permits short contractual limitation periods. However, the forum here is Vermont, and – as Crowe concedes (Crowe Mem. at 6-7) – Vermont has the predominant interest in this matter. That interest is such that Vermont law applies and overrides the contractual provision.

As a Vermont domiciled insurer, Global Hawk was subject to regulation by the Department, *see* 8 V.S.A. §§ 6050 *et seq*. Vermont requires insurers to file both annual financial statements, 8 V.S.A. § 6007, and annual financial statements audited by a qualified independent certified public accountant. Vt. Admin. Code 4-6-4:4; Vt. Admin. Code 4-6-1:3. Crowe expressly acknowleged in its Letters of Qualifications that the Department will rely on the audited statements and its audit reports. Vermont plainly has a substantial interest in claims respecting audits of its domestic insurers and the application of its law to those claims. *Cf. Long v. Parry*, 921 F. Supp.2d 269, 275-277 (D. Vt. 2013) (noting Vermont interest in claims against lawyers based on litigation in Vermont courts). Illinois, by contrast, has no particular interest in this matter. Crowe cannot create such an interest by a choice of law provision.[11]

[11] Indeed, Illinois treats statutes of limitations and the defenses thereto as procedural matters governed by the law of the forum. *See Belleville Toyota, Inc. v. Toyota Motor Sales, U.S.A., Inc.*, 770 N.E.2d 177, 194 (Ill. 2002); *Heiman*

The contractual limitation violates a forum state statute. *See Stamp Tech, Inc. ex rel Blair v. Ludall/Thermal Acoustical, Inc.*, 987 A.2d 292, 298-299 (Vt. 2009). The parties could not explicitly contract to make the clause valid in the face of the public policy of Vermont, and Vermont law applies both because Illinois has no substantial relationship to the transaction and because application of Illinois law to permit a limitation would be contrary to a fundamental policy of Vermont, the state with the materially greater interest. *See Kearney v. Okemo LLC*, 2016 WL 4257459 at *3-4 (D. Vt. Aug. 11, 2016) (discussing Restatement (Second) of Conflicts of Laws § 187). The Vermont statute controls, and the limitation is null and void.

VII. The Engagement Letter's Consequential Damages Limitation Does Not Apply To Tort Claims, Is Waived, And In Any Event Is Not Enforceable.

Crowe seeks dismissal of all counts respecting the 2016 audit based on the exculpatory consequential damages provision in the 2016 "Crowe Engagement Terms" (but not in later years). The provision does not apply to the tort claims, is waived, and is void as against public policy.

1. As an initial matter, the provision does not apply to tort claims for professional negligence, which are causes of action separate from breach of contract. *See Lamell Lumber Corp. v. NewStress Int'l., Inc.*, 938 A.2d 1215, 1224 (Vt. 2007) (recognizing separate tort of professional negligence, although it arises from contractual responsibilities). "Contractual disclaimers of liability for negligence have traditionally been disfavored. They are subject to more exacting judicial scrutiny than other contractual provisions, and thus a greater degree of clarity is required to make them effective." *Housing Vermont v. Goldsmith & Morris*, 685 A.2d

v. Bimbo Foods Bakeries, 902 F.3d 715, 718 (7th Cir. 2018). The Vermont limitations period is six years. 12 V.S.A. § 511. The Liquidator does not agree that the relevant date for limitations purposes is December 1, 2020; it is no later than June 8, 2020 under 8 V.S.A. § 7063.

1086, 1089 (Vt. 1996) (citing *Colgan v. Agway, Inc.*, 553 A.2d 143, 145 (Vt. 1988)). *See Thompson v. Hi Tech Motor Sports, Inc.*, 945 A.2d 368, 375 (Vt. 2008). The provision is found in the "Crowe Engagement Terms," which set out "the terms under which Crowe provides its services" and state that "[t]hese terms are part of the Agreement." The provision does not refer to negligence, and the phrase "[a]ny liability" in the context of this "term" of the "Agreement" refers to contractual liability, not tort liability.[12]

2. In any event, Crowe waived the provision. In paragraph (f) of its 2016 Letter of Qualification (Exhibit A), Crowe represented it was in compliance with the requirements of Section 7 of the NAIC Annual Financial Reporting Model Regulation regarding qualifications of independent certified public accountants. Section 7(a)(2) of the NAIC model provides that a firm is not a qualified accountant if it has directly or indirectly entered an agreement of indemnity or release from liability ("indemnification") with respect to the audit. *See* Section 3(E) (defining "Indemnification"). The model (MO-205) is available on the NAIC website, https://content.naic.org/model-laws; §§ Sections 7 and 3 are attached as Exhibit D. By representing that it complied with the model's qualification requirements, Crowe waived the provision limiting damages. *See Merit Behavioral Care*, 845 A.2d at 365. In addition, the Vermont (and Illinois) regulations based on the model (discussed below) are incorporated in the contract as a matter of law (*see* note 10), and they override the inconsistent provision.

3. Finally, the provision is void as a matter of public policy. It is an exculpatory provision. Not only does it bar a broad list of damages, including consequential damages, it also

[12] Illinois also construes exculpatory clauses strictly. *Horne v. Electric Eel Mfg. Co., Inc.*, 987 F.3d 704, 718 (7th Cir. 2021) (quoting *Scott & Fetzer Co. v. Montgomery Ward & Co.*, 493 N.E.2d 1022, 1029 (Ill. 1986)); *Hawkins v. Capital Fitness, Inc.*, 29 N.E.3d 442, 448 (Ill. App. Ct. 2015). Further, a party cannot promise one thing in one part of a contract (here, to perform an audit in accordance with professional standards for material misstatement whether due to error or fraud) and then exculpate itself from liability for breach of that promise in another. *See Jewelers Mut. Ins. Co. v. Firstar Bank Illinois*, 820 N.E.2d 411, 415-416 (Ill. 2004).

purports to excuse Crowe "even if Crowe had reason to know of the possibility of such damages." This has the effect of insulating Crowe from the consequences of its breaches of its duty of due care. The clause amounts to an exculpation for all breaches and negligence, and it is unenforceable as a matter of public policy. *See* Restatement (Third) of Torts: Liab. For Econ. Harm § 4, comment e.[13] Vermont's public policy on this point is set forth in regulations:

> The commissioner shall not recognize a person or firm as a qualified independent certified public accountant if the person or firm . . . (2) [h]as either directly or indirectly entered into an agreement of indemnity or release from liability (collectively referred to as *indemnification*) with respect to the audit of the RRG.

Vt. Admin. Code 4-6-4:7. The provision is an "Indemnification," which is defined as:

> an agreement of indemnity or a release from liability where the intent or effect is to shift or limit in any manner the potential liability of the person or firm for failure to adhere to applicable auditing or professional standards, whether or not resulting in part from knowing o[r] other misrepresentations made by the RRG or its representatives.

Vt. Admin. Code 4-6-4:3. (Illinois has the same public policy, as it also has promulgated the regulation. 50 Ill. Admin. Code §§ 925.70, 925.30.)

Whether the provision violates public policy is a question of Vermont law, as Vermont has the greatest interest in this matter and Crowe cannot contract around Vermont public policy. *See* pages 20-21 above. The question is generally evaluated with reference to the "*Tunkl* standards." *Glassford v. BrickKicker*, 35 A.3d 1044, 1050 (Vt. 2011) (citing *Tunkl v. Regents of Univ. of Cal.*, 383 P.3d 441, 444 (Cal. 1963)). But no single formula applies. *See Thompson*, 945 A.2d at 371-372. Here the regulation and factors discussed below render the clause void.

Crowe is a national accounting firm that provides audit services to the public, including insurance companies. Complaint ¶ 4. Accounting is a regulated profession. *See* 26 V.S.A.

[13] The provision is unenforceable as to both contract and tort causes of action. *See Dubey v. Public Storage, Inc.*, 918 N.E.2d 265, 275-276 (Ill. App. Ct. 2009) (same provision cannot be "both void and not void") (quoting *Economy Mechanical Industries, Inc. v. T.J. Higgins Co.,* 689 N.E.2d 199, 201-202 (Ill. App. Ct. 1997)).

ch. 1. Reports on financial statements can only be issued by a licensed or registered accountant. 26 V.S.A. § 14. Insurers are required to file audited financial statements. *See* note 2 above. Accountant's auditing services are thus a practical necessity for insurers.

There is a substantial public interest in the provision of auditing services to insurers that extends beyond the insurers' own interest in reliably presenting their financial condition. The insurance-buying public, and the universe of persons who may have claims against those insured (*i.e.*, the general public), have a great stake in the financial condition and solvency of insurers. *See In re Ambassador*, 114 A.3d at 498-499. The public thus has an interest in the provision of competent auditing services to insurers. Competent audits are crucial to ensure that insurers' financial reports are accurate, so that the public may have confidence that the promises of coverage made in insurance policies can be honored. In this context, an exculpatory provision is not just a question of allocating risk among contracting parties; it implicates the public interest.

If accountants could exempt themselves from damages, it would eliminate the most important incentive for proper performance. As professionals, auditors apply professional standards in their work independent of their contract.[14] This is in great part why they are subject to liability for economic loss. *See* Restatement (Third) of Torts: Liab. For Econ. Harm § 4, comment a.[15] Given the intrinsically financial nature of auditing services, exempting

[14] Crowe acknowledges this. *See* 2016 Engagement Letter, "Crowe Engagement Terms" ("PROFESSIONAL STANDARDS – As a regulated professional services firm, Crowe must follow certain professional standards where applicable, including the Code of Professional Conduct promulgated by the American Institute of Certified Public Accountants ('AICPA')." *See also* 2016 Engagement Letter at 1 ("We will plan and perform the audit in accordance with auditing standards generally accepted in the United States of America (GAAS)."

[15] *See* Restatement (Third) of Torts: Liab. For Econ. Harm § 4, comment b; *e.g., Congregation of the Passion, Holy Cross Province v. Touche Ross & Co.*, 636 N.E.2d 503, 512-515 (Ill. 1994) (accountants are members of a skilled profession whose "duty to observe reasonable professional competence exists independently of any contract" such that the economic loss doctrine does not bar recovery in tort for accountant malpractice); *see also Sutton v. Vermont Regional Center*, 238 A.3d 608, 621-622 (Vt. 2020) (discussing "special relationship" or "professional duty" exception to economic loss rule; citing cases); *Springfield Hydroelectric Co. v. Copp*, 779 A.2d 67, 72 (Vt. 2001).

accountants from consequential damages would effectively insulate them from meaningful liability for breach of their independent duty of due care to their clients and – through insurance regulators – the policyholders and creditors. It would exempt auditors from their independent duties recognized by statute, *see* 26 V.S.A. § 76 (unprofessional conduct includes negligence), and regulation, *e.g.*, Vt. Admin. Code 4-6-4. It would harm the policyholders and creditors intended to be protected by the requirement that insurers file audited financial statements.

The provision is substantively unconscionable for these same reasons. *See Val Preda Leasing, Inc. v. Rodriguez*, 540 A.2d 648, 652 (Vt. 1987). It effectively exempts Crowe from any meaningful remedy for failing to perform its professional obligations. *See Gingras v. Think Finance, Inc.*, 922 F.3d 112, 127-128 (2d Cir. 2019) (arbitration clause providing illusory remedy is substantively unconscionable under Vermont law).

Conclusion

For these reasons, Crowe's motion to dismiss should be denied. If the Court were to grant the motion, in whole or in part, the Liquidator requests the opportunity to amend.

Respectfully submitted,

MICHAEL S. PIECIAK, COMMISSIONER OF THE VERMONT DEPARTMENT OF FINANCIAL REGULATION, AS LIQUIDATOR OF GLOBAL HAWK INSURANCE COMPANY RISK RETENTION GROUP,

By his attorneys,

February 4, 2022

/s/ Eric A. Smith
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CERTIFICATE OF SERVICE

I hereby certify that on this 4th day of February 2022, a true and correct copy of Plaintiff's Memorandum in Opposition to Defendant's Motion to Dismiss was served by ECF on all counsel of record.

_/s/ Jennifer Rood

Exhibit A

Crowe Horwath LLP
Independent Member Crowe Horwath International

Board of Directors
Global Hawk Insurance Company Risk Retention Group

We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of Global Hawk Insurance Company Risk Retention Group (the Company) for the years ended December 31, 2016 and 2015, and have issued our report thereon dated June 30, 2017. In connection therewith, we advise you as follows:

a. We are independent certified public accountants with respect to the Company and conform to the standards of the accounting profession as contained in the Code of Professional Conduct and pronouncements of the American Institute of Certified Public Accountants and the Rules of Professional Conduct of the Connecticut State Board of Public Accountancy.

b. The engagement partner, who is a certified public accountant, has eighteen years of experience in public accounting and is experienced in auditing insurance entities. Members of the engagement team, all of whom have had experience in auditing insurance entities and 67% of whom are certified public accountants, were assigned to perform tasks commensurate with their training and experience.

c. We understand that the Company intends to file its audited financial statements and our report thereon with the Vermont Department of Financial Regulation and other state insurance departments in which the Company is licensed and that the Insurance Commissioner will be relying on that information in monitoring and regulating the financial condition of the Company.

While we understand that an objective of issuing a report on the financial statements is to satisfy regulatory requirements, our audit was not planned to satisfy all objectives or responsibilities of the insurance regulators. In this context, the Company and Insurance Commissioner should understand that the objective of an audit of the financial statements in accordance with auditing standards generally accepted in the United States of America is to form an opinion and issue a report on whether the financial statements present fairly in all material respects, the financial position, results of operations, and cash flows in conformity with accounting principles generally accepted in the United States of America. Consequently, under auditing standards generally accepted in the United States of America, we have the responsibility, within the inherent limitations of the auditing process, to plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud, and to exercise due professional care in the conduct of the audit. The concept of selective testing of the data being audited, which involves judgment both as to the number of transactions to be audited and the areas to be tested, has been generally accepted as a valid and sufficient basis for an auditor to express an opinion on financial statements. Audit procedures that are effective for detecting errors, if they exist, may be ineffective for detecting misstatements resulting from fraud. Because of the characteristics of fraud, a properly planned and performed audit may not detect a material misstatement resulting from fraud. In addition, an audit does not address the possibility that material misstatements caused by error or fraud may occur in the future. Also, our use of professional judgment and the assessment of materiality for the purpose of our audit means that matters may exist that would have been assessed differently by the Insurance Commissioner.

It is the responsibility of the management of the Company to adopt sound accounting policies, to maintain an adequate and effective system of accounts, and to establish and maintain an internal control structure that will, among other things, provide reasonable but not absolute assurance that assets are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America.

The Insurance Commissioner should exercise due diligence to obtain whatever other information that may be necessary for the purpose of monitoring and regulating the financial position of insurers and should not rely solely upon the independent auditor's report.

d. We will retain the workpapers prepared in the conduct of our audit until the Vermont Department of Financial Regulation has filed a Report on Examination covering 2016, but no longer than seven years. After notification to the Company, we will make the workpapers available for review by the Vermont Department of Financial Regulation at the offices of the insurer, at our offices, at the Insurance Department or at any other reasonable place designated by the Insurance Commissioner. Furthermore, in the conduct of the aforementioned periodic review by the Vermont Department of Financial Regulation, photocopies of pertinent audit workpapers may be made (under the control of the accountant) and such copies may be retained by the Vermont Department of Financial Regulation. In addition, to the extent requested, we may provide the Vermont Department of Financial Regulation with copies of certain of our audit working papers (such as unlocked electronic copies of Excel spreadsheets that do not contain password protection or encryption). As such, these audit working papers will be subject to potential modification the Vermont Department of Financial Regulation or by others. We are not responsible for any modifications made to the copies, electronic or otherwise, after they are provided to the Vermont Department of Financial Regulation and we are likewise not responsible for any effect that any such modifications, whether intentional or not, might have on the process, substance or outcome of your regulatory examination.

e. The engagement partner has served in that capacity with respect to the Company since 2012, is licensed by the Connecticut State Board of Accountancy with CPA mobility allowing for the signing of our opinion in the State of Vermont, and is a member in good standing of the American Institute of Certified Public Accountants.

f. To the best of our knowledge and belief, we are in compliance with the requirements of Section 7 of the NAIC's Annual Financial Reporting Model Regulation "Requiring Annual Audited Financial Reports" regarding qualifications of independent certified public accountants.

The letter is intended solely for the information and use of the Board of Directors, management, the Vermont Department of Financial Regulation and is not intended to be and should not be used by anyone other than these specified parties.

Crowe Horwath LLP

Crowe Horwath LLP

Simsbury, Connecticut
June 30, 2017

Exhibit B

Crowe Horwath LLP
Independent Member Crowe Horwath International

Board of Directors
Global Hawk Insurance Company Risk Retention Group

We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of Global Hawk Insurance Company Risk Retention Group (the Company) for the years ended December 31, 2017 and 2016, and have issued our report thereon dated June 29, 2018. In connection therewith, we advise you as follows:

a. We are independent certified public accountants with respect to the Company and conform to the standards of the accounting profession as contained in the Code of Professional Conduct and pronouncements of the American Institute of Certified Public Accountants and the Rules of Professional Conduct of the Connecticut State Board of Public Accountancy.

b. The engagement partner, who is a certified public accountant, has thirty five years of experience in public accounting and is experienced in auditing insurance entities. Members of the engagement team, all of whom have had experience in auditing insurance entities and 71% of whom are certified public accountants, were assigned to perform tasks commensurate with their training and experience.

c. We understand that the Company intends to file its audited financial statements and our report thereon with the Vermont Department of Financial Regulation and that the Insurance Commissioner will be relying on that information in monitoring and regulating the financial condition of the Company.

   While we understand that an objective of issuing a report on the financial statements is to satisfy regulatory requirements, our audit was not planned to satisfy all objectives or responsibilities of the insurance regulators. In this context, the Company and Insurance Commissioner should understand that the objective of an audit of the financial statements in accordance with auditing standards generally accepted in the United States of America is to form an opinion and issue a report on whether the financial statements present fairly in all material respects, the financial position, results of operations, and cash flows in conformity with accounting principles generally accepted in the United States of America. Consequently, under auditing standards generally accepted in the United States of America, we have the responsibility, within the inherent limitations of the auditing process, to plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud, and to exercise due professional care in the conduct of the audit. The concept of selective testing of the data being audited, which involves judgment both as to the number of transactions to be audited and the areas to be tested, has been generally accepted as a valid and sufficient basis for an auditor to express an opinion on financial statements. Audit procedures that are effective for detecting errors, if they exist, may be ineffective for detecting misstatements resulting from fraud. Because of the characteristics of fraud, a properly planned and performed audit may not detect a material misstatement resulting from fraud. In addition, an audit does not address the possibility that material misstatements caused by error or fraud may occur in the future. Also, our use of professional judgment and the assessment of materiality for the purpose of our audit means that matters may exist that would have been assessed differently by the Insurance Commissioner.

   It is the responsibility of the management of the Company to adopt sound accounting policies, to maintain an adequate and effective system of accounts, and to establish and maintain an internal control structure that will, among other things, provide reasonable but not absolute assurance that assets are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America.

The Insurance Commissioner should exercise due diligence to obtain whatever other information that may be necessary for the purpose of monitoring and regulating the financial position of insurers and should not rely solely upon the independent auditor's report.

d. We will retain the workpapers prepared in the conduct of our audit until the Vermont Department of Financial Regulation has filed a Report on Examination covering 2017, but no longer than seven years. After notification to the Company, we will make the workpapers available for review by the Vermont Department of Financial Regulation at the offices of the insurer, at our offices, at the Insurance Department or at any other reasonable place designated by the Insurance Commissioner. Furthermore, in the conduct of the aforementioned periodic review by the Vermont Department of Financial Regulation, photocopies of pertinent audit workpapers may be made (under the control of the accountant) and such copies may be retained by the Vermont Department of Financial Regulation. In addition, to the extent requested, we may provide the Vermont Department of Financial Regulation with copies of certain of our audit working papers (such as unlocked electronic copies of Excel spreadsheets that do not contain password protection or encryption). As such, these audit working papers will be subject to potential modification the Vermont Department of Financial Regulation or by others. We are not responsible for any modifications made to the copies, electronic or otherwise, after they are provided to the Vermont Department of Financial Regulation and we are likewise not responsible for any effect that any such modifications, whether intentional or not, might have on the process, substance or outcome of your regulatory examination.

e. The engagement partner has served in that capacity with respect to the Company since 2017, is licensed by the Connecticut State Board of Accountancy with CPA mobility allowing for the signing of our opinion in the State of Vermont, and is a member in good standing of the American Institute of Certified Public Accountants.

f. To the best of our knowledge and belief, we are in compliance with the requirements of Section 7 of the NAIC's Annual Financial Reporting Model Regulation "Requiring Annual Audited Financial Reports" regarding qualifications of independent certified public accountants.

The letter is intended solely for the information and use of the Board of Directors, management, the Vermont Department of Financial Regulation and is not intended to be and should not be used by anyone other than these specified parties.

Crowe Horwath LLP

Crowe Horwath LLP

Simsbury, Connecticut
June 29, 2018

Exhibit C

Crowe LLP
Independent Member Crowe Global

Board of Directors
Global Hawk Insurance Company Risk Retention Group

We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of Global Hawk Insurance Company Risk Retention Group (the Company) for the years ended December 31, 2018 and 2017, and have issued our report thereon dated June 28, 2019. In connection therewith, we advise you as follows:

a. We are independent certified public accountants with respect to the Company and conform to the standards of the accounting profession as contained in the Code of Professional Conduct and pronouncements of the American Institute of Certified Public Accountants and the Rules of Professional Conduct of the Connecticut Board of Public Accountancy.

b. The engagement partner, who is a certified public accountant, has twenty-three years of experience in public accounting and is experienced in auditing insurance entities. Members of the engagement team, all of whom have had experience in auditing insurance entities and 80% of whom are certified public accountants, were assigned to perform tasks commensurate with their training and experience.

c. We understand that the Company intends to file its audited financial statements and our report thereon with the Vermont Department of Financial Regulation in which the Company is licensed and that the Insurance Commissioner will be relying on that information in monitoring and regulating the financial condition of the Company.

   While we understand that an objective of issuing a report on the financial statements is to satisfy regulatory requirements, our audit was not planned to satisfy all objectives or responsibilities of the insurance regulators. In this context, the Company and Insurance Commissioner should understand that the objective of an audit of the financial statements in accordance with auditing standards generally accepted in the United States of America is to form an opinion and issue a report on whether the financial statements present fairly in all material respects, the financial position, results of operations, and cash flows in conformity with accounting principles generally accepted in the United States of America. Consequently, under auditing standards generally accepted in the United States of America, we have the responsibility, within the inherent limitations of the auditing process, to plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud, and to exercise due professional care in the conduct of the audit. The concept of selective testing of the data being audited, which involves judgment both as to the number of transactions to be audited and the areas to be tested, has been generally accepted as a valid and sufficient basis for an auditor to express an opinion on financial statements. Audit procedures that are effective for detecting errors, if they exist, may be ineffective for detecting misstatements resulting from fraud. Because of the characteristics of fraud, a properly planned and performed audit may not detect a material misstatement resulting from fraud. In addition, an audit does not address the possibility that material misstatements caused by error or fraud may occur in the future. Also, our use of professional judgment and the assessment of materiality for the purpose of our audit means that matters may exist that would have been assessed differently by the Insurance Commissioner.

   It is the responsibility of the management of the Company to adopt sound accounting policies, to maintain an adequate and effective system of accounts, and to establish and maintain an internal control structure that will, among other things, provide reasonable but not absolute assurance that assets are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America.

The Insurance Commissioner should exercise due diligence to obtain whatever other information that may be necessary for the purpose of monitoring and regulating the financial position of insurers and should not rely solely upon the independent auditor's report.

d. We will retain the workpapers prepared in the conduct of our audit until the Vermont Department of Financial Regulation has filed a Report on Examination covering 2018, but no longer than seven years. After notification to the Company, we will make the workpapers available for review by the Vermont Department of Financial Regulation at the offices of the insurer, at our offices, at the Insurance Department or at any other reasonable place designated by the Insurance Commissioner. Furthermore, in the conduct of the aforementioned periodic review by the Vermont Department of Financial Regulation, photocopies of pertinent audit workpapers may be made (under the control of the accountant) and such copies may be retained by the Vermont Department of Financial Regulation. In addition, to the extent requested, we may provide the Vermont Department of Financial Regulation with copies of certain of our audit working papers (such as unlocked electronic copies of Excel spreadsheets that do not contain password protection or encryption). As such, these audit working papers will be subject to potential modification the Vermont Department of Financial Regulation or by others. We are not responsible for any modifications made to the copies, electronic or otherwise, after they are provided to the Vermont Department of Financial Regulation and we are likewise not responsible for any effect that any such modifications, whether intentional or not, might have on the process, substance or outcome of your regulatory examination.

e. The engagement partner has served in that capacity with respect to the Company since 2018, is licensed by the Connecticut State Board of Accountancy with CPA mobility allowing for the signing of our opinion in the State of Vermont, and is a member in good standing of the American Institute of Certified Public Accountants.

f. To the best of our knowledge and belief, we are in compliance with the requirements of Section 7 of the NAIC's Annual Financial Reporting Model Regulation "Requiring Annual Audited Financial Reports" regarding qualifications of independent certified public accountants.

The letter is intended solely for the information and use of the Vermont Department of Financial Regulation and is not intended to be and should not be used by anyone other than these specified parties.

Crowe LLP

Crowe LLP

Simsbury, Connecticut
June 28, 2019

Exhibit D

ANNUAL FINANCIAL REPORTING MODEL REGULATION

Table of Contents

Section 1. Authority

This regulation is promulgated by the commissioner of insurance pursuant to Sections [insert applicable sections] of the [insert state] insurance law.

Section 2. Purpose and Scope

The purpose of this regulation is to improve the [insert state] Insurance Department's surveillance of the financial condition of insurers by requiring (1) an annual audit of financial statements reporting the financial position and the results of operations of insurers by independent certified public accountants, (2) Communication of Internal Control Related Matters Noted in an Audit, and (3) Management's Report of Internal Control over Financial Reporting.

Every insurer (as defined in Section 3) shall be subject to this regulation. Insurers having direct premiums written in this state of less than $1,000,000 in any calendar year and less than 1,000 policyholders or certificate holders of direct written policies nationwide at the end of the calendar year shall be exempt from this regulation for the year (unless the commissioner makes a specific finding that compliance is necessary for the commissioner to carry out statutory responsibilities) except that insurers having assumed premiums pursuant to contracts and/or treaties of reinsurance of $1,000,000 or more will not be so exempt.

Foreign or alien insurers filing the audited financial report in another state, pursuant to that state's requirement for filing of audited financial reports, which has been found by the commissioner to be substantially similar to the requirements herein, are exempt from Sections 4 through 13 of this regulation if:

A. A copy of the audited financial report, Communication of Internal Control Related Matters Noted in an Audit, and the Accountant's Letter of Qualifications that are filed with the other state are filed with the commissioner in accordance with the filing dates specified in Sections 4, 11 and 12, respectively (Canadian insurers may submit accountants' reports as filed with the Office of the Superintendent of Financial Institutions, Canada).

B. A copy of any Notification of Adverse Financial Condition Report filed with the other state is filed with the commissioner within the time specified in Section 10.

Foreign or alien insurers required to file Management's Report of Internal Control over Financial Reporting in another state are exempt from filing the report in this state provided the other state has substantially similar reporting requirements and the report is filed with the commissioner of the other state within the time specified.

This regulation shall not prohibit, preclude or in any way limit the commissioner of insurance from ordering or conducting or performing examinations of insurers under the rules and regulations of the [insert state] Department of Insurance and the practices and procedures of the [insert state] Department of Insurance.

Section 3. Definitions

The terms and definitions contained herein are intended to provide definitional guidance as the terms are used within this regulation.

A. "Accountant" or "independent certified public accountant" means an independent certified public accountant or accounting firm in good standing with the American Institute of Certified Public Accountants (AICPA) and in all states in which he or she is licensed to practice; for Canadian and British companies, it means a Canadian-chartered or British-chartered accountant.

B. An "affiliate" of, or person "affiliated" with, a specific person, is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified.

C. "Audit committee" means a committee (or equivalent body) established by the board of directors of an entity for the purpose of overseeing the accounting and financial reporting processes of an insurer or group of insurers, the internal audit function of an insurer or group of insurers (if applicable), and external audits of financial statements of the insurer or group of insurers. The audit committee of any entity that controls a group of insurers may be deemed to be the audit committee for one or more of these controlled insurers solely for the purposes of this regulation at the election of the controlling person. Refer to Section 14F for exercising this election. If an audit committee is not designated by the insurer, the insurer's entire board of directors shall constitute the audit committee.

D. "Audited financial report" means and includes those items specified in Section 5 of this regulation.

E. "Indemnification" means an agreement of indemnity or a release from liability where the intent or effect is to shift or limit in any manner the potential liability of the person or firm for failure to adhere to applicable auditing or professional standards, whether or not resulting in part from knowing of other misrepresentations made by the insurer or its representatives.

F. "Independent board member" has the same meaning as described in Section 14C.

G. "Insurer" means a licensed insurer as defined in Sections [insert applicable sections] of the [insert state] insurance law or an authorized insurer as defined in Sections [insert applicable sections] of the [insert state] insurance law.

H. "Group of insurers" means those licensed insurers included in the reporting requirements of [insert state law equivalent of the model Insurance Holding Company System Regulatory Act], or a set of insurers as identified by management, for the purpose of assessing the effectiveness of Internal control over financial reporting.

I. "Internal audit function" means a person or persons that provide independent, objective and reasonable assurance designed to add value and improve an organization's operations and accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

J. "Internal control over financial reporting" means a process effected by an entity's board of directors, management and other personnel designed to provide reasonable assurance regarding the reliability of the financial statements, i.e., those items specified in Section 5B through 5G of this regulation and includes those policies and procedures that:

(1) Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of assets;

(2) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of the financial statements, i.e., those items specified in Section 5B through 5G of this regulation and that receipts and expenditures are being made only in accordance with authorizations of management and directors; and

(3) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on the financial statements, i.e., those items specified in Section 5B through 5G of this regulation.

K. "SEC" means the United States Securities and Exchange Commission.

L. "Section 404" means Section 404 of the Sarbanes-Oxley Act of 2002 and the SEC's rules and regulations promulgated thereunder.

M. "Section 404 Report" means management's report on "internal control over financial reporting" as defined by the SEC and the related attestation report of the independent certified public accountant as described in Section 3A.

N. "SOX Compliant Entity" means an entity that either is required to be compliant with, or voluntarily is compliant with, all of the following provisions of the Sarbanes-Oxley Act of 2002: (i) the preapproval requirements of Section 201 (Section 10A(i) of the Securities Exchange Act of 1934); (ii) the Audit committee independence requirements of Section 301 (Section 10A(m)(3) of the Securities Exchange Act of 1934); and (iii) the Internal control over financial reporting requirements of Section 404 (Item 308 of SEC Regulation S-K).

Section 4. General Requirements Related to Filing and Extensions for Filing of Annual Audited Financial Reports and Audit Committee Appointment

A. All insurers shall have an annual audit by an independent certified public accountant and shall file an audited financial report with the commissioner on or before June 1 for the year ended December 31 immediately preceding. The commissioner may require an insurer to file an audited financial report earlier than June 1 with ninety (90) days advance notice to the insurer.

B. Extensions of the June 1 filing date may be granted by the commissioner for thirty-day periods upon a showing by the insurer and its independent certified public accountant of the reasons for requesting an extension and determination by the commissioner of good cause for an extension. The request for extension must be submitted in writing not less than ten (10) days prior to the due date in sufficient detail to permit the commissioner to make an informed decision with respect to the requested extension.

C. If an extension is granted in accordance with the provisions in Section 4B, a similar extension of thirty (30) days is granted to the filing of Management's Report of Internal Control over Financial Reporting.

D. Every insurer required to file an annual audited financial report pursuant to this regulation shall designate a group of individuals as constituting its audit committee, as defined in Section 3. The audit committee of an entity that controls an insurer may be deemed to be the insurer's audit committee for purposes of this regulation at the election of the controlling person.

Section 5. Contents of Annual Audited Financial Report

The annual audited financial report shall report the financial position of the insurer as of the end of the most recent calendar year and the results of its operations, cash flows and changes in capital and surplus for the year then ended in conformity with statutory accounting practices prescribed, or otherwise permitted, by the Department of Insurance of the state of domicile.

Section 7. Qualifications of Independent Certified Public Accountant

A. The commissioner shall not recognize a person or firm as a qualified independent certified public accountant if the person or firm:

(1) Is not in good standing with the AICPA and in all states in which the accountant is licensed to practice, or, for a Canadian or British company, that is not a chartered accountant; or

(2) Has either directly or indirectly entered into an agreement of indemnity or release from liability (collectively referred to as *indemnification*) with respect to the audit of the insurer.

B. Except as otherwise provided in this regulation, the commissioner shall recognize an independent certified public accountant as qualified as long as he or she conforms to the standards of his or her profession, as contained in the Code of Professional Ethics of the AICPA and Rules and Regulations and Code of Ethics and Rules of Professional Conduct of the [insert state] Board of Public Accountancy, or similar code.

C. A qualified independent certified public accountant may enter into an agreement with an insurer to have disputes relating to an audit resolved by mediation or arbitration. However, in the event of a delinquency proceeding commenced against the insurer under [cite applicable receivership statute], the mediation or arbitration provisions shall operate at the option of the statutory successor.

D. (1) The lead (or coordinating) audit partner (having primary responsibility for the audit) may not act in that capacity for more than five (5) consecutive years. The person shall be disqualified from acting in that or a similar capacity for the same company or its insurance subsidiaries or affiliates for a period of five (5) consecutive years. An insurer may make application to the commissioner for relief from the above rotation requirement on the basis of unusual circumstances. This application should be made at least thirty (30) days before the end of the calendar year. The commissioner may consider the following factors in determining if the relief should be granted:

(a) Number of partners, expertise of the partners or the number of insurance clients in the currently registered firm;

(b) Premium volume of the insurer; or

(c) Number of jurisdictions in which the insurer transacts business.

(2) The insurer shall file, with its annual statement filing, the approval for relief from Subsection D(1) with the states that it is licensed in or doing business in and with the NAIC. If the nondomestic state accepts electronic filing with the NAIC, the insurer shall file the approval in an electronic format acceptable to the NAIC.

E. The commissioner shall neither recognize as a qualified independent certified public accountant, nor accept an annual audited financial report, prepared in whole or in part by, a natural person who:

(1) Has been convicted of fraud, bribery, a violation of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. Sections 1961 to 1968, or any dishonest conduct or practices under federal or state law;

(2) Has been found to have violated the insurance laws of this state with respect to any previous reports submitted under this regulation; or

(3) Has demonstrated a pattern or practice of failing to detect or disclose material information in previous reports filed under the provisions of this regulation.

F. The commissioner of insurance, as provided in Section [insert applicable section] of the insurance code, may, as provided in [insert applicable citation], hold a hearing to determine whether an independent certified public accountant is qualified and, considering the evidence presented, may rule that the accountant is not qualified for purposes of expressing his or her opinion on the financial statements in the annual audited financial report made pursuant to this regulation and require the insurer to replace the accountant with another whose relationship with the insurer is qualified within the meaning of this regulation.

G. (1) The commissioner shall not recognize as a qualified independent certified public accountant, nor accept an annual audited financial report, prepared in whole or in part by an accountant who provides to an insurer, contemporaneously with the audit, the following non-audit services:

(a) Bookkeeping or other services related to the accounting records or financial statements of the insurer;

(b) Financial information systems design and implementation;

(c) Appraisal or valuation services, fairness opinions, or contribution-in-kind reports;

(d) Actuarially-oriented advisory services involving the determination of amounts recorded in the financial statements. The accountant may assist an insurer in understanding the methods, assumptions and inputs used in the determination of amounts recorded in the financial statement only if it is reasonable to conclude that the services provided will not be subject to audit procedures during an audit of the insurer's financial statements. An accountant's actuary may also issue an actuarial opinion or certification ("opinion") on an insurer's reserves if the following conditions have been met:

(i) Neither the accountant nor the accountant's actuary has performed any management functions or made any management decisions;

(ii) The insurer has competent personnel (or engages a third party actuary) to estimate the reserves for which management takes responsibility; and

(iii) The accountant's actuary tests the reasonableness of the reserves after the insurer's management has determined the amount of the reserves;

(e) Internal audit outsourcing services;

(f) Management functions or human resources;

(g) Broker or dealer, investment adviser, or investment banking services;

(h) Legal services or expert services unrelated to the audit; or

(i) Any other services that the commissioner determines, by regulation, are impermissible.

Drafting Note: Any additions or deletions from the list of prohibited services by a state must be carefully considered as uniformity among states is essential in this section. In determining whether other services are impermissible, the commissioner shall consider utilizing the guidance provided in the SEC's Final Rule No. 33-8183, *Strengthening the Commission's Requirements Regarding Auditor Independence* adopted January 28, 2003, in order to evaluate whether the provision of such services impairs the independence of the accountant.

(2) In general, the principles of independence with respect to services provided by the qualified independent certified public accountant are largely predicated on three basic principles, violations of which would impair the accountant's independence. The principles are that the accountant cannot function in the role of management, cannot audit his or her own work, and cannot serve in an advocacy role for the insurer.

H. Insurers having direct written and assumed premiums of less than $100,000,000 in any calendar year may request an exemption from Subsection G(1). The insurer shall file with the commissioner a written statement discussing the reasons why the insurer should be exempt from these provisions. If the commissioner finds, upon review of this statement, that compliance with this regulation would constitute a financial or organizational hardship upon the insurer, an exemption may be granted.

I. A qualified independent certified public accountant who performs the audit may engage in other non-audit services, including tax services, that are not described in Subsection G(1) or that do not conflict with Subsection G(2), only if the activity is approved in advance by the Audit committee, in accordance with Subsection J.

Drafting Note: A qualified independent certified public accountant who performs the audit may also engage in other non-audit services for an insurer, including tax services, that are not described in Subsection G(1) or that do not conflict with Subsection G(2) if the audit committee is in compliance with the SEC's Final Rule No. 33-8183, *Strengthening the Commission's Requirements Regarding Auditor Independence* adopted January 28, 2003, and has approved such activity.

J. All auditing services and non-audit services provided to an insurer by the qualified independent certified public accountant of the insurer shall be preapproved by the audit committee. The preapproval requirement is waived with respect to non-audit services if the insurer is a SOX Compliant Entity or a direct or indirect wholly-owned subsidiary of a SOX Compliant Entity or:

(1) The aggregate amount of all such non-audit services provided to the insurer constitutes not more than five percent (5%) of the total amount of fees paid by the insurer to its qualified independent certified public accountant during the fiscal year in which the non-audit services are provided;

(2) The services were not recognized by the insurer at the time of the engagement to be non-audit services; and

(3) The services are promptly brought to the attention of the audit committee 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 the members of the board of directors to whom authority to grant such approvals has been delegated by the audit committee.

K. The audit committee may delegate to one or more designated members of the audit committee the authority to grant the preapprovals required by Subsection J. The decisions of any member to whom this authority is delegated shall be presented to the full audit committee at each of its scheduled meetings.

L. (1) The commissioner shall not recognize an independent certified public accountant as qualified for a particular insurer if a member of the board, president, chief executive officer, controller, chief financial officer, chief accounting officer, or any person serving in an equivalent position for that insurer, was employed by the independent certified public accountant and participated in the audit of that insurer during the one-year period preceding the date that the most current statutory opinion is due. This section shall only apply to partners and senior managers involved in the audit. An insurer may make application to the commissioner for relief from the above requirement on the basis of unusual circumstances.

(2) The insurer shall file, with its annual statement filing, the approval for relief from Subsection L(1) with the states that it is licensed in or doing business in and the NAIC. If the nondomestic state accepts electronic filing with the NAIC, the insurer shall file the approval in an electronic format acceptable to the NAIC.

Section 8. Consolidated or Combined Audits

An insurer may make written application to the commissioner for approval to file audited consolidated or combined financial statements in lieu of separate annual audited financial statements if the insurer is part of a group of insurance companies that utilizes a pooling or 100 percent reinsurance agreement that affects the solvency and integrity of the insurer's reserves and the insurer cedes all of its direct and assumed business to the pool. In such cases, a columnar consolidating or combining worksheet shall be filed with the report, as follows:

