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Pricewaterhouse May Be on Hook for Failed Insurer's \$45 Million in Losses

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A Mercer County judge has given a boost to New Jersey's attempt to hold Pricewaterhouse Coopers liable for more than \$45 million in losses by the insolvent Home State Insurance Co.

Superior Court Judge Paul Koenig found as a matter of law that PWC audits of Home State before the state took over the company in 1997 violated statutory accounting principles.

Barring a successful appeal, the bench trial scheduled for April will be limited to whether the accounting giant's actions were the proximate cause of the state's loss and, if so, the amount of damages.

PWC argued that whether the audits were based on the proper standards is a fact question requiring expert testimony. But such testimony is irrelevant because the statutory standards under which Home State was required to operate are what the Department of Banking and Insurance says they are, Koenig ruled on Jan. 26 in Suter v. Pricewaterhouse Coopers, Mer-L-1742-01.

According to DOBI Commissioner Karen Suter's complaint, PWC's audits allowed Home State to overstate its capital and surplus by at least \$3.3 million in 1993 and by even higher sums in 1994 and 1995.

If Home State's dismal balance sheet at the end of 1993 had been reported accurately, the company would have been taken over then at a lesser loss, rather than in 1997 when the losses had deepened, the suit says. In addition to the alleged loss of \$45 million caused by the delay, the state is seeking interest and legal fees.

Home State had 40,000 private passenger and 1,000 commercial auto policies in effect when it failed. The state's Property Liability Insurance Guaranty Association has paid \$69 million in claims for Home State insureds.

The DOBI's counsel, David Mazie of Roseland's Mazie Slater Katz & Freeman, argued in the summary judgment motion granted by Koenig that PWC failed to recognize that Home State was not using statutory principles in accounting for Home State's income and payments to reinsurers. The standards are promulgated by the National Association of Insurance Commissioners.

Instead of crediting Home State for its share of commission income shared by reinsurers when the payments were made, Home State counted the income as its own when the policies were written, DOBI says. "Home State's accounting was clearly inconsistent with one of the primary objectives of the Statutory Accounting Principles, that of not recognizing income until it is actually earned," Mazie's brief says.

Just as bad, the company reported profits from arrangements with reinsurers, but not losses, resulting in the reporting of phantom income. "PWC breached the standard of care by failing to require that Home State include all appropriate ceded losses and loss expenses in the profit sharing calculations, which allowed Home State to erroneously report millions of dollars of income," the brief says.

Mazie and defense counsel William Reilly of McCarter & English decline to comment, so it is not known whether PWC plans to appeal.

Reilly argued that a company's commission of accounting errors does not prove that the auditor violated professional standards. He argued that the issue of whether PWC violated standards is not a question for summary judgment in favor of the plaintiff, who is also the rule-maker.

"There is no precedent for affording any deference, let alone binding weight, to the self-serving advocacy positions of the DOBI," the defense brief says.

Given conflicting views by each side's experts, "summary judgment is improper in those circumstances, and plaintiff cannot make it otherwise by asking her own agency to weigh in and tip the scales in her favor in the litigation," the brief said.

The state has already recovered from another professional working for the insurer.

In March 2005, Home State's actuary, Miliman & Robertson of Seattle, paid \$7.5 million to settle a claim that it was responsible for too-low calculations of what had to be set aside for property and casualty reserves. If the proper calculations had been reported, the state would have found out in 1993 that the company was shaky and would have

acted immediately, the complaint said.