No. 10-1306

IN THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

GRANT THORNTON LLP,
Appellant – Cross-Appellee,

v.

FEDERAL DEPOSIT INSURANCE CORPORATION,
Appellee – Cross-Appellant.

On Appeal from the United States District Court
for the Southern District of West Virginia

Honorable Judge David A. Faber, District Judge
Case Nos. 1:00-cv-00655 & 1:03-cv-02129

PROOF RESPONSE/REPLY BRIEF FOR GRANT THORNTON LLP

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INTRODUCTION

The $25 million judgment against Grant Thornton was produced by the FDIC's overreaching and the district court's errors. Keystone had successfully disguised its deep insolvency for years before Grant Thornton performed a single audit of the Bank's financial statements. To justify shifting all responsibility for Keystone's continued operation to Grant Thornton, the FDIC persuaded the district court to apply novel legal rules that would greatly expand the agency's power to obtain massive damages from auditors of failed banks.

The FDIC's theory that Grant Thornton proximately caused Keystone's operating losses would apply wherever a bank's auditor failed to discover financial problems that would have caused the bank to close. Despite this, the FDIC cannot name a single bank failure case in which its causation theory previously has been adopted by a court. The district court nevertheless readily accepted it. It also dismissed all of Grant Thornton's affirmative defenses and counterclaims based on Keystone management's misconduct. And it afforded Grant Thornton only a minimal credit for the FDIC's settlement with Keystone's outside law firm.

As we explained in our opening brief and discuss further in this Reply, these purely legal errors require reversal of the judgment. In addition, if this Court reaches the question, the FDIC's cross-appeal must be rejected because the district court did not abuse its discretion in denying the FDIC's request for prejudgment

interest. In fact, FIRREA precludes any award of prejudgment interest because the damages did not result from the "improvident or otherwise improper" use or investment of the Bank's assets; moreover, prejudgment interest is not "appropriate" because Grant Thornton had no way of calculating its damages prior to the judgment.

Before we address the FDIC's flawed legal arguments, it is useful to point out the significant facts on which the parties agree.

First, Keystone's financial difficulties were unrelated to the one audit. The FDIC concedes (FB2) that when Grant Thornton was retained, Keystone was hopelessly insolvent as the result of unprofitable loan securitizations, mismanagement and embezzlement.[1] It concedes that there were no new securitizations or embezzlements after the audit, and it does not contend that Keystone made any expenditures in specific reliance on the audit.

Second, Grant Thornton was not engaged to conduct a fraud audit or opine on the Bank's solvency. As the FDIC's brief explains, Grant Thornton was hired to "determine the appropriateness of Keystone's accounting" (FB3) after the OCC discovered certain "accounting deficiencies" (FB2).

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[1] We cite the FDIC's brief as "FB__" and Grant Thornton's opening brief as "GB__."

Third, Keystone's managers interfered with the audit. They fabricated documents and repeatedly lied to the auditors—including by certifying falsely, in a letter written on behalf of Keystone, that the information being provided to the auditors was truthful and accurate. Moreover, the FDIC fails to explain the irregularities in the confirmation process. It does not venture to guess why Compu-Link confirmed all $227 million of the loans Keystone claimed to own when it was servicing loans worth only $14 million. And although the FDIC extensively discusses Buenger's handling of the Advanta confirmation (FB4-6), it does not explain why Ramirez—like Compu-Link—sent Buenger information about United-owned loans in an amount that precisely confirmed the fraudulently-inflated numbers on Keystone's books.

While the FDIC never suggests that Grant Thornton was complicit in the fraud,[2] it contends that Grant Thornton was highly negligent in failing to discover

[2] At most, the FDIC contends that Buenger's testimony about the Ramirez phone call was "an untruthful post hoc attempt to conceal" her "blunder" in failing to obtain written confirmation that the loans Ramirez reported in her e-mail belonged to Keystone. FB5-6. But the FDIC's criticism of Buenger is overstated. For example, the Ramirez e-mail stated that United was the "investor," not that it "owned" the loans. FB5. There was undisputed testimony that the "investor" need not be the owner (6/3/04 Tr. 73-74), and a host of trial evidence supported the conclusion that Keystone owned those loans—including evidence that it violated industry practice to respond to a confirmation request relating to one bank with loan balance information from another bank. *See* GB10. Furthermore, the district court did not find that Buenger "falsified her workpapers" (FB6); it found that she "made changes to her workpapers" (Dkt. 540, ¶ 112)—changes that were immaterial to the key audit issues.

the fraud. FB6-7. That the fraud remained hidden for years despite "repeated[]" OCC investigations that "never uncovered the extent of the fraud" (FB2) belies that contention. However, Grant Thornton has not appealed the district court's negligence determination, and the FDIC's legal arguments do not depend on the severity of the negligence.

Fourth, the damages claimed by the FDIC represent the routine costs of keeping the Bank open. The FDIC does not contend that these expenditures were illegal or improper or were undertaken in specific reliance on the audit report. It argues only that the regulators and the Bank's non-corrupt Board members would have closed the Bank had the fraud been discovered.

Finally, the circumstances that give rise to Grant Thornton's request for a $22 million settlement credit are undisputed. The FDIC settled with Kutak without allocating the proceeds between the damages caused by Kutak alone and those attributable jointly to Kutak and Grant Thornton. It thereafter argued that Grant Thornton should receive no settlement credit because there were no overlapping damages. It finally acknowledged the overlap only after it was ordered to produce its right-to-sue memorandum—which proved that the FDIC deemed Kutak responsible for the same operating losses attributed to Grant Thornton.

Given these undisputed facts, West Virginia law does not support holding Grant Thornton liable for 100% (less a small settlement credit) of the Bank's net

operating expenses after April 21, 1999. As we show below, (1) Grant Thornton did not proximately cause the losses claimed by the FDIC; (2) it should not have been precluded from presenting defenses and counterclaims based on Keystone management's misconduct; and (3) it should have received a dollar-for-dollar credit for the entire Kutak settlement rather than the small percentage derived from a flawed allocation proceeding. Finally, given the many disputed legal and factual issues relating to the proper measure of damages and the appropriate settlement credit, the district court did not abuse its discretion in holding that the FDIC should not receive prejudgment interest.

ARGUMENT

I. GRANT THORNTON DID NOT PROXIMATELY CAUSE THE DAMAGES CLAIMED BY THE FDIC

A. The FDIC's Claimed Damages Lack A Direct Relationship To, And Were Not The Foreseeable Result Of, Grant Thornton's Audit Report.

In our opening brief, we explained that Grant Thornton's negligence was a *"but-for"* cause, but not a *proximate* cause, of Keystone's operating losses. We also showed that the FDIC's proposed causation theory would empower that agency to seek massive damages from third-party service providers in virtually every bank failure case: Whenever the FDIC takes over as receiver, it will likely be able to argue that the bank would have closed earlier, and would have avoided paying deposit interest and other routine expenses, but for the negligent conduct of

the bank's outside law or accounting firms. The FDIC does not deny the practical impact of its expansive reading of proximate causation, but it cannot demonstrate that the district court's aggressive approach comports with West Virginia law.

1. As a matter of law, Grant Thornton cannot be held liable for injuries not directly and foreseeably resulting from its breach of duty.

The district court's legal errors must be reviewed *de novo*. Although the FDIC describes proximate causation as an issue of fact (FB14-15), such issues present "questions of fact for the [fact-finder] where the evidence is conflicting or when the facts, though undisputed, are such that reasonable men draw different conclusions from them." *Mays v. Chang*, 579 S.E.2d 561, 565 (W. Va. 2003) (quoted at FB14). The question before this Court does not turn on any disputed issues of fact, but is a purely legal one: Under West Virginia law, may an auditor be held liable for a bank's operating losses because the auditor, in performing some of its procedures negligently, missed an opportunity to discover that the bank's records fraudulently disguised a preexisting insolvency, the revelation of which would have led to the bank's earlier closure? *That* issue is one of law—as is shown by the district court's extended effort to distinguish the cases cited in Grant Thornton's brief. Dkt. 540 at 84-92.

The trial court recited the proper legal standard, but did not apply that standard correctly. In its view and that of the FDIC, any injury resulting from a

breach is foreseeable so long as it is not "unnatural or improbable." FB18. West Virginia, however, requires more: the injury must be "produce[d]" "in a natural and continuous sequence" by the breach, *Hudnall v. Mate Creek Trucking*, 490 S.E.2d 56, 61 (W. Va. 1997), and must be "directly related" to the "claims … asserted against the defendants." *Lively v. Rufus*, 533 S.E.2d 662, 668 n.11 (W. Va. 2000); *see also Bridge v. Phoenix Bond & Indem. Co.*, 553 U.S. 639, 654 (2008) (when a court evaluates a proximate-cause question, "the central question it must ask is whether the alleged violation led directly to the plaintiff's injuries"); *Anza v. Ideal Steel Supply Corp.*, 547 U.S. 451, 457 (2006) ("the common-law foundations of the proximate-cause requirement" include a "direct relation between the injury asserted and the injurious conduct alleged").

For damages to relate directly to the defendant's breach of duty, they must reflect the *type* of harm that reasonably can be expected to result from the breach: "[T]he scope of the defendant's liability [must be] determined by the scope of the risk he negligently created." 1 Dan B. Dobbs, *The Law of Torts* § 187, at 463 (2001); *cf. Movitz v. First Nat'l Bank of Chicago*, 148 F.3d 760, 763 (7th Cir. 1998); *Matthews v. Cumberland & Allegheny Gas Co.*, 77 S.E.2d 180 (W. Va. 1953).

The FDIC failed to show that the Bank's post-audit operating losses, or even the delay in the Bank's closure, were the direct result of Grant Thornton's breach,

or were therefore proximately caused by that breach under West Virginia law. Instead, the FDIC's theory abandons the traditional limits of proximate causation, assessing liability for every consequence but the "unnatural or improbable"—liability that is wildly out of proportion to Grant Thornton's negligence. The district court's acceptance of that theory was legal error.

2. The Bank's post-audit operating losses were not directly and foreseeably produced by Grant Thornton's breach.

The district court awarded damages based on *all* of Keystone's operating losses, starting two days after the audit concluded. These losses have no relation to Grant Thornton's responsibilities as an auditor. The FDIC does not contend that any of the Bank's expenditures were made in specific reliance on the audit findings, nor does it contend that Grant Thornton caused or contributed to the imbalance between Keystone's income and its expenditures. To the contrary, the FDIC argues that it is "legally irrelevant" that "Keystone did not rely on the audit report to enter into the[] unprofitable transactions that preexisted the audit, or to pay the expenses it incurred in the ordinary course of business." FB24. The FDIC argues only that because the Bank would have ceased to operate at all had the fraud had been discovered, *every* expense, no matter how unrelated to the audit—unless offset by income that would not have been earned but for the Bank's continued operation—counts as damages from Grant Thornton's negligence. *See* FB8-9. That is merely but-for causation, not proximate causation.

a. The FDIC's proximate causation theory amounts to nothing more than the contention that Grant Thornton created the occasion of the injury by allowing the Bank to continue to exist. *See Perry v. Melton*, 299 S.E.2d 8, 11 (W. Va. 1982) (explaining that West Virginia law distinguishes "between the proximate cause of an injury and the condition or occasion of the injury"). The district court based its proximate cause determination on its theory that Grant Thornton "allowed a dangerous condition to continue: *i.e.*, Keystone's continued operation despite the fraud and overwhelming insolvency," which resulted in "the Bank continuing to pay foreseeable interest expenses, dividends, salaries, etc." Dkt. 540 at 91-92. But the Bank's "interest expenses, dividends, [or] salaries" were not directly related to Grant Thornton's audit report: The FDIC can say only that they would not have occurred "but for" the failure to close the bank. FB8-9.

As this Court has stated, "[a]n Act which merely furnishes the condition or occasion upon which injuries are received, but which does not put in motion the agency by or through which the injuries are inflicted, does not constitute the proximate cause of the harm." *Ente Nazionale Per L'Engergia v. Baliwag Navigation, Inc.*, 774 F.2d 648, 655-56 (4th Cir. 1985). If the consequence of an auditor's error is merely to extend the life of an insolvent corporation, and nothing more, such conduct "d[oes] no more than furnish the condition that ma[kes] the plaintiff's injury possible." *Askanase v. Fatjo*, 130 F.3d 657, 676 (5th Cir. 1997).

Awarding damages in such circumstances "would make [the auditor] an insurer of [the corporation,] because [the auditor] would be liable for [the corporation's] losses" no matter what causes them. *Id.*; *accord Trustees of AFTRA Health Fund v. Biondi*, 303 F.3d 765 (7th Cir. 2002).

b. The FDIC contends that "'condition' cases such as *Askanase*" are inapposite because, in the case at bar, there is the "unique" fact that "regulators [were] carefully watching the Bank" (FB21), making it "*particularly* foreseeable that Defendants' negligen[ce] … would prevent regulators from closing the [B]ank and result in [its] continued operation" (*id.* at 20). The same could be said whenever a firm is asked to audit a troubled bank. Indeed, *all* banks are subject to federal oversight, and any bank will be closed if it found to be deeply insolvent. *Askanase*'s logic does not depend on how likely it is that a bank will close: The point is that the damages claimed must be directly related to the auditor's breach of duty. Here, the Bank's interest payments were in no way "produce[d]" by errors in Grant Thornton's audit, *Hudnall*, 490 S.E.2d at 61, even if that audit served as a but-for cause.[3]

[3] The FDIC contends that "the mere existence of other causes for the injury is not enough to disprove causation." FB19. But Grant Thornton does not argue that the audit was one of several proximate causes of Keystone's operating losses; rather, the relationship between Grant Thornton's conduct and those damages was insufficiently direct to establish proximate causation *at all*.

The FDIC seeks to distinguish numerous similar cases on the ground that they involve securities claims. FB24. That is a distinction without a difference. The same proximate cause standard applies in both contexts, and the cases turned on the conclusion that the damages were too remote from defendant's actions to establish proximate causation—even assuming the existence of "but-for" causation. *See*, *e.g., Gasner v. Board of Supervisors*, 103 F.3d 351, 360 (4th Cir. 1996); *Bloor v. Carro, Spandock, Londin, Rodman & Fass*, 754 F.2d 57, 61-62 (2d Cir. 1985); *In re Parmalat Securities Litigation*, 421 F. Supp. 2d 703, 722 (S.D.N.Y. 2006). Although negligence, unlike securities fraud, does not require reliance to establish the underlying *breach*, reliance *is* crucial to demonstrate *causation*: a mistaken audit report can only be blamed for losses resulting from someone's reliance on that report.[4] That is why *Maxwell v. KPMG LLP*, 520 F.3d 713 (7th Cir. 2008)—a negligence case, not a securities case, and one that the FDIC fails to mention—analyzed the proximate causation question by examining the nature of the duty assumed by the auditor and distinguishing between "transaction causation" and "loss causation." *See id.* at 717.

That distinction compels the conclusion that Grant Thornton cannot be held liable for Keystone's operating expenses here. The FDIC's assertion that "there

[4] We do not contend that accountants can be liable only if they provide "investment advice," as the FDIC contends (PB12). Our point is that the harm must be directly related to and result from the accountant's work product.

was reliance here" because the audit was a but-for cause of not closing the Bank (FB25), hardly shows that Grant Thornton's conduct produced the Bank's underlying financial condition, its prior acceptance of deposits, or its usual operating expenses.

c. Put another way, even assuming that the delayed closure of the Bank was a direct consequence within Grant Thornton's duty to prevent (an assumption refuted below), the losses that the district court attributed to the non-closure were not. *See Hemi Group, LLC v. City of New York*, 130 S. Ct. 983, 989 (2010) (noting "the general tendency of the law, in regard to damages at least … not to go beyond the first step") (internal quotation marks omitted).

Grant Thornton's audit had no connection whatsoever to the manner in which the Bank subsequently chose to manage its existing deposits, whether or how it would invest new deposits, whether it would pay dividends, how much it would pay its employees, or how much it would spend on postage. *None* of these decisions was foreseeable and within the scope of Grant Thornton's duty to anticipate. The FDIC asserts that "if Keystone suffered an uninsured business loss due to lightning, that extraordinary and unlikely expense might not be foreseeable" (FB22), but nothing in its theory imposes that limitation; buildings are struck by lightning all the time.

In fact, the biggest driver of damages was the amount of time that the Bank stayed open following the audit, and that factor was both totally unforeseeable and totally unconnected to Grant Thornton's duties as an auditor. The FDIC suggests that "a four-month delay was entirely probable and foreseeable," while a longer period "might be unforeseeable" (FB23). But it sought damages for much longer than four months. The FDIC's theory imposes no logical stopping point, and nothing in the district court's opinion suggests that it would not have awarded damages for a longer period had the fraud, which had lain hidden for years, continued to escape detection for many more. The issue is not whether Grant Thornton could have foreseen "the precise chain of events leading to the injury" (FB16 (internal quotation marks omitted)), such as the names of the individual depositors harmed. Rather, it is whether Grant Thornton's audit report, "in a natural and continuous sequence, produce[d]" the Bank's wage payments to pre-existing employees and interest payments on pre-existing debts. *Hudnall*, 490 S.E.2d at 61.

d. Revealingly, the FDIC defends its theory by citing cases that *did* involve distinct post-audit conduct resulting from specific reliance on an audit report. For example, in *Thabault v. Chait*, 541 F.3d 512 (3d Cir. 2008), the auditor failed to advise an insurer that it "should not have continued writing new insurance policies," *id.* at 517. Because the insurer "relied on the [audit] to continue writing

insurance policies," *id*. at 524, which "cost the company more than the premiums," *id.* at 519, the auditor was held liable for losses "aris[ing] from the continued writing of insurance policies," *id.* at 520. Here, by contrast, the damages were principally comprised of interest on deposits that had already been accepted prior to the audit, and Grant Thornton cannot be held liable for those damages under West Virginia law. *See Lively,* 533 S.E.2d at 669 ("debts which the plaintiff was already responsible for regardless of the defendant's actions" cannot be the "basis of recovery" from the defendant).

The same is true of other cases cited by the FDIC and the district court, such as *Comeau v. Rupp*, 810 F. Supp. 1172 (D. Kan. 1992), and *Lincoln Grain, Inc. v. Coopers & Lybrand*, 345 N.W.2d 300 (Neb. 1984). In *Comeau*, the FDIC alleged that an auditor failed to identify problems with loans purchased from a mortgage corporation, leading to new purchases by the client and additional losses. 810 F. Supp. at 1176. The FDIC concedes (FB25-26) that in *Comeau*, unlike here, the plaintiff's reliance on the auditor's advice led to new transactions producing new losses. It describes that distinction as unimportant, because Grant Thornton was held liable only for the "preventable aggravation after April 21"; but what the FDIC calls "aggravation" of losses is only the Bank's continued routine operations. Such expenses are unrelated to the duty undertaken by Grant Thornton and are not the direct or foreseeable result of a departure from that duty.

Likewise, in *Lincoln Grain*, the auditors' failure to detect falsifications led to similar new falsifications and resulting damages. 345 N.W.2d 308-09. The FDIC cites *Lincoln Grain* for the proposition that "it is foreseeable … that the failure to discover a fraud will result in the continuation of that fraud." FB26. But the damages claimed by the FDIC here involved no additional fraud at all, and cannot be attributed to Grant Thornton's report.

3. The timing of the Bank's closure was not directly and foreseeably produced by Grant Thornton's breach.

The FDIC's theory hinges on the proposition that Grant Thornton's audit report altered the timing of the Bank's closure. Although a but-for consequence of Grant Thornton's breach, this outcome was neither directly produced nor foreseeable, except in hindsight.

a. As the FDIC recognizes, the scope of Grant Thornton's obligations must be assessed as of "*the time of the engagement*." FB16. At that time, Grant Thornton made clear that its audit was not "a special examination designed to seek defalcations or fraud"—which it offered to perform in a separate engagement—"nor a guarantee of the accuracy of the consolidated financial statements." FDIC Ex. 96. Rather, Grant Thornton undertook to "examin[e], on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assess[] the accounting principles used and significant estimates made by management, [and] evaluat[e] the overall financial statement presentation," based

in part on "written representation from management concerning such matters upon which we will rely." *Id.*

West Virginia law "recognize[s] that … there are several types of accounting audits," and "in weighing the accountant's duty," courts will "look to the nature of the accounting work contracted." *First Nat'l Bank of Bluefield v. Crawford*, 386 S.E.2d 310, 313-14 (W. Va. 1989). Even if Grant Thornton owed "a duty to opine on (and carefully check) whether the Bank's asset representations were free of material misstatements" (FB16-17), a breach of *that* duty could not reasonably have been expected to make Grant Thornton responsible to pay all of Keystone's ordinary operating expenses until it closed.

b. Grant Thornton did not undertake any general duty to advise the Bank about whether to continue in business. Although the FDIC dismisses this fact as a "red herring," it concedes that Grant Thornton "had no duty to opine on the Bank's solvency." FB16. Grant Thornton was not asked, for example, to opine on whether the Bank owned enough loans to be able to afford continuing to pay interest on its deposits. Accordingly, Grant Thornton should not be expected to have anticipated that a finding of negligence would shift to it the responsibility to insure any losses resulting from the Bank's continuation in business.

c. The specific duty that Grant Thornton actually undertook was not directly related to the Bank's subsequent injuries. The FDIC contends that Grant

Thornton must pay for the Bank's post-audit operations because its breach was the but-for cause of a "failure to discover a 500-million-dollar misstatement," which in turn resulted in "the failure to close the Bank on April 21." FB18. The FDIC further contends that "[t]his consequence was highly probable or foreseeable because it is a virtual certainty that the Bank's Board or regulators would have closed Keystone if it lacked $500 million." FB8. But that argument does not rest on foreseeability, *i.e.*, what may reasonably be anticipated about the *future*. Rather, the argument rests entirely on hindsight. An auditor who *knew* that Keystone lacked $500 million might well expect the Bank to close, but Grant Thornton undisputedly did *not* know that Keystone's management had intentionally falsified its books to disguise its deep insolvency and did *not* undertake to insure Keystone against the possibility of such a circumstance. Indeed, no one—not even regulators—identified the risk of massive fraud at the Bank. *See* FDIC 471 (1998 report of examination for Keystone).

The FDIC contends that, while "[a] causal relationship is not direct or proximate if it involves an improbable, unusual, or extraordinary chain of events," "[n]othing in the record shows that closing a bank with a 500-million-dollar loss (and with liabilities ten times its assets) would have been unusual or improbable." FB20. Again, that hindsight reasoning is misplaced. In fact, the failure to shut down a bank whose deep insolvency has been successfully disguised for years by

management despite repeated regulatory investigations is not the "probable, usual, or ordinary" result of any departure from the duty to "opine on (and carefully check) whether the Bank's asset representations were free of material misstatements." FB16-17. Nor did any of the alleged "red flags" cited by the FDIC (FB3) come close to indicating that Keystone's book were essentially fictional. Indeed, the FDIC does not argue that an auditor in Grant Thornton's position, *either before or during the audit*, knew or should have known that Keystone was insolvent by hundreds of millions of dollars.[5]

d. If Grant Thornton can be held liable for Keystone's operating losses, then the same thing would be true whenever an auditor fails to uncover problems that would shut down the audited entity. After all, it is *always* theoretically possible that a bank that appears solvent may actually be hiding a $500 million fraud. Under the FDIC's theory, therefore, whenever an accounting firm audits a bank's financial statements, it must—particularly if the bank is experiencing any trouble—be prepared to become an insurer for the bank's future operating losses, including *all* of the interest due to *all* of the bank's depositors. The FDIC shrinks from expressly defending such "liability in an indeterminate amount for an indeterminate time to an indeterminate class," *Ernst & Ernst v. Hochfelder*, 425

[5] The FDIC contends that Buenger "blunder[ed]" in failing to obtain written confirmation of the Ramirez telephone call. FB6. It does not contend, however, that Buenger knew or should have known based on the Advanta confirmation that Keystone was insolvent and should close—nor did the district court so find.

U.S. 185, 214 n.33, but that is the necessary implication of the rule for which it argues.

The FDIC's rule would contravene the basic purpose of West Virginia's law of proximate causation: "the need to draw a line to prevent unfettered imposition of unlimited exposure to liability." *Aikens v. Debow*, 541 S.E.2d 576, 582 (W. Va. 2000). "In a philosophical sense, the consequences of an act go forward to eternity, and the causes of an event go back to the dawn of human events, and beyond. But any attempt to impose responsibility upon such a basis would result in infinite liability for all wrongful acts, and would set society on edge and fill the courts with endless litigation." *Holmes v. Sec. Investor Protection Corp.*, 503 U.S. 258, 266 n.10 (1992). Proximate causation recognizes that "the judicial remedy cannot encompass every conceivable harm that can be traced to alleged wrongdoing," *Aikens*, 541 S.E.2d at 582 (internal quotation marks omitted), and that "it is bad policy to encourage people harmed in some natural or financial disaster to cast about for someone on whom to lay off the consequences who had, however, committed only a technical breach of duty," *Movitz*, 148 F.3d at 763. That is why West Virginia law is "deliberately restrictive" of auditor liability, "to encourage the free flow of commercial information." *Ellis v. Grant Thornton LLP*, 530 F.3d 280, 289 (4th Cir. 2008).

"[W]hen clients fail financially, the CPA auditor is a prime target in litigation claiming investor and creditor economic losses[,] because it is the only available (and solvent) entity that had any direct contact with the client's business affairs." *Bily v. Arthur Young & Co.*, 834 P.2d 745, 763 (Cal. 1992). Auditors can be expected to stand by their reports and to be held responsible for their client's specific reliance thereon. But they cannot be held liable for losses they could not foresee and did not directly produce.[6] Indeed, imposition of such open-ended liabilities would only discourage audit professionals from giving badly needed services to companies facing financial difficulties. The district court's judgment contravenes these principles and must be reversed.

B. Keystone Management's Misconduct Was An Intervening Cause.

Even if Grant Thornton proximately caused Keystone's losses immediately following the audit, it should not be held liable for any losses following the onset of the OCC's subsequent examination. If Keystone management had not interfered with that examination, the Bank would have closed earlier—making that interference a more direct cause of Keystone's damages than the prior audit. *See Sergent v. City of Charleston,* 549 S.E.2d 311, 320 (W. Va. 2001) ("The proximate cause of the injury is the last negligent act contributing to the injury and without

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[6] The FDIC's suggestion that auditors would "escape liability" (FB24) under Grant Thornton's approach is incorrect. The FDIC might have sought damages proximately caused by Grant Thornton's negligence, such as payments made in reliance on the audit report, but it failed to do so.

which the injury would not have occurred."). The FDIC does not defend the district court's flawed rationale for rejecting Grant Thornton's intervening cause argument (FB27), but proposes several alternative grounds for affirmance. None is valid.

1. The FDIC initially notes that Grant Thornton did not appeal the district court's rejection of its separate argument that the OCC's regulatory failure was an intervening cause. FB27. The FDIC posits that, in rejecting Grant Thornton's "regulatory failure argument," the district court "necessarily rejected … the subsumed management-interference-caused-the-regulatory-failure argument." *Id.* It then insists that Grant Thornton's failure to appeal the district court's "regulatory failure" holding dooms its separate argument "that management's interference was an intervening cause." FB27-28.

This argument is meritless. First, even assuming that the two rulings were interdependent, Grant Thornton did not forfeit its ability to obtain relief from one holding by not challenging both in its opening brief. To the contrary, having raised a challenge to the trial court's holding on its management-interference-intervening-cause argument, Grant Thornton necessarily challenged any subsidiary holdings upon which that ruling implicitly depends.

Second, the district court's "regulatory failure" holding *did not* resolve the argument raised here. The district court rejected Grant Thornton's regulatory

failure defense principally on the ground that the regulators did not owe a duty to Keystone, its shareholders, or Grant Thornton. Dkt. 540 at 109-116. It then added that even if the intervening cause defense were not legally barred, "the pre-receivership conduct of the FDIC and OCC … was not 'a negligent act, or omission, which constitutes a new effective cause and operates independently of any other act, making it and only it the proximate cause of the injury.'" *Id.* at 116. A holding that *regulators* did not commit a "negligent act, or omission" that qualifies as an intervening cause does not constitute a holding that *Keystone management* did not commit such an act.

2. The FDIC also denies that "the OCC's delay in uncovering the missing loans was due to management interference." FB28. But the district court found that Keystone management stymied the OCC's examiners' efforts to obtain accurate records from the servicers. It stated, for example, that "bank examiners had difficulty obtaining accurate records from the servicers" (Dkt. 540, ¶ 98); that Keystone's managers "made several efforts to have Advanta and Compu-Link respond to the OCC with information on loans owned by United as well as Keystone, in order to keep the fraud concealed" (*id.* ¶ 99); and that "bank examiners learned that Keystone had the ability to manipulate servicer data and servicer reports that, while appearing to come directly from the servicers, were actually prepared by the Bank" (*id.* ¶ 101). The fraud would have been discovered

significantly earlier but for management's efforts to stymie the OCC's inquiries. *See, e.g.*, FDIC Exs. 353, 354, 369, 413.

Indeed, the OCC's own account of the "Obstruction of Asset Quality Examination by Keystone Employees" (FDIC Ex. 413) shows that the requests would have been sent on June 30—and the responses received shortly thereafter—had Keystone's managers not intervened. That OCC memorandum explains:

> On June 30, 1999, we decided to request additional information from the servicers. Our request was precipitated by questions regarding significant loan balance fluctuations, erratic due date charges, etc from month to month among the servicers. I wrote letters to the following servicers: Compulink, Ocwen, and Advanta. As a courtesy before mailing the letters, EIC Mark Blair informed Terry Church of our intentions, *she requested that the servicer information be sent to the bank and not the FO. We relented.*

Id. at 1 (emphasis added). Later, the OCC learned that a Keystone manager had immediately written to the servicers "requesting information on <u>all loans and loans in securitizations</u>"—*i.e.*, loans owned by United as well as Keystone. *Id.* And on July 12, 1999, "Terry Church provided [an OCC examiner] with 3 computer disks and a hard paper print out of disk contents," falsely representing that "these disks had been received from Compulink and Advanta." *Id.* at 2. The OCC examiner "unwittingly used this information to review the loan portfolio," but "later learned that these documents had been altered and manipulated by Keystone employees." *Id.* And when the OCC finally spoke to servicers directly on August 23, they

learned that Keystone employees had intercepted the information meant for the OCC. *Id.* at 4. This timeline, which also details other efforts by Keystone management to obstruct the examination, makes clear that the fraud would have been discovered shortly after June 30 had management not interfered. It also completely refutes the FDIC's assertion that "it was actually Defendant's glowing audit—not management interference—that delayed OCC's discovery of the missing loans." FB29.

3. The FDIC argues that "the continued management misconduct" was "a normal incident of the risk created" by the negligent audit (FB31), but that contention lacks any record support. Grant Thornton was a victim of Keystone management's well-practiced and longstanding efforts to cover up its financial condition, which had successfully prevented either the FDIC or the OCC from discovering the fraud despite multiple investigations. *See* GB5 (describing prior investigations); GT Ex. 47 at 2 (OCC memorandum stating that, "[g]iven that [Keystone managers] interfered with OCC's independent verification requests to servicers, the format of the external auditor's confirmation provided ample opportunity and the likelihood that insiders intervened in confirmations of loan balances by" Grant Thornton). The audit in no way "created" the "risk" that Keystone management would similarly interfere with the OCC's investigation.

The FDIC's denial that management's interference "operate[d] independently" from Grant Thornton's prior conduct also is futile. There is no evidence that "the credibility imparted by *Defendant's* audit" caused the OCC "to allow[] management to act the way it did." FB30-31. Keystone's managers used other methods of persuasion to divert the regulators' questions. *See, e.g.*, FDIC Ex. 413, at 1 (recounting Keystone manager's argument that if the OCC contacted the servicers directly "[t]he servicers might be alarmed that something was wrong" and "it could lessen the bank's chances of being able to sell loans in the market place").

4. In sum, the district court clearly erred in dismissing, on imputation grounds, an intervening-cause defense that was strongly supported by undisputed evidence. If this Court rejects the argument that Grant Thornton did not proximately cause Keystone's operating losses at all, it should order the district court to determine when the Bank would have closed absent management interference with the OCC's examination and to excise from the judgment any damages incurred after that date.

II. THE TRIAL COURT ERRED IN STRIKING GRANT THORNTON'S AFFIRMATIVE DEFENSES AND DISMISSING ITS COUNTERCLAIMS

The district court dismissed Grant Thornton's defenses of comparative negligence, in pari delicto, and fraud based on its sweeping legal conclusion that

West Virginia law precludes the imputation of bank management's misconduct to a receiver. The FDIC's effort to defend the wholesale preclusion of Grant Thornton's defenses (FB32-46) is unpersuasive.

A. The District Court Erred In Concluding That West Virginia Law Precludes All Defenses Based On Imputation Of Management's Knowledge Or Conduct To The FDIC.

In attempting to defend the district court's categorical preclusion of Grant Thornton's defenses, the FDIC first contends that "West Virginia public policy prevents application of the [imputation] doctrine to receivers." FB 13. In fact, West Virginia's sparse case law addressing imputation in suits by receivers does not support the dismissal of Grant Thornton's defenses based on audit interference.

1. As we explained in our opening brief, "the FDIC as receiver 'steps into the shoes' of the failed [bank], obtaining the rights '*of* the insured depository institution' that existed prior to receivership." *O'Melveny & Myers v. FDIC*, 512 U.S. 79, 86 (1994). Thus, while state law governs the substantive standards under which its claims are to be judged, federal law surely governs the FDIC's standing and precludes application of a broad no-imputation-to-the-FDIC-as-receiver rule. *See* GB 40-42. The FDIC fails to respond to this argument.

2. Even assuming that West Virginia law governs, the FDIC fails to show that West Virginia's receivership law would preclude all defenses based on management's misconduct and audit interference. The FDIC relies almost

exclusively on *Cordial v. Ernst & Young*, 483 S.E.2d 249 (W. Va. 1996) (*see* FB34-37), but the district court and the FDIC both recognized that *Cordial* did not resolve the issue. *See* Dkt. 540 at 95; Dkt. 880 in 2:99-0992 at 12. Furthermore, *Cordial* did *not* "expressly [hold] that public policy prevented imputation-based defenses." FB35. Instead, the WVSCA, in a footnote to its holding that the Insurance Commissioner had standing to sue, merely rejected the contention that that the Commissioner "could not bring a valid claim" against the company's auditor because "Blue Cross's managers indisputably knew what its financial condition was." *Cordial*, 483 S.E.2d at 257 n.9. *Cordial* did not suggest that the WVSCA would preclude *all* defenses involving imputation of management's knowledge or conduct to *any* receiver. In fact, the court distinguished, but did not overrule, a prior case involving a *banking* receiver based on the specific statutory provisions governing *insurance* receivers, and of course the FDIC is a banking receiver. *Id.*

3. The FDIC's effort to analogize its status to that of the insurance receiver in *Cordial* is unpersuasive. Contrary to the FDIC's contention that "any FDIC recovery will ultimately be distributed to the creditors and customers of the bank" (FB35), the proceeds will be used to pay the FDIC's administrative costs and reimburse the Deposit Insurance Fund, which is funded by participating banks. *See* 12 U.S.C. § 1821(d)(11); *FDIC v. Bierman*, 2 F.3d 1424, 1439 (7th Cir. 1993)

(explaining that the FDIC's "task is to replenish the insurance fund"). The FDIC (FB35-36) points to *Cordial*'s quotation from *Bierman* that "the duty of FDIC to collect on assets of a failed institution runs to the public" (*Bierman*, 2 F.3d at 1428), but the West Virginia court deemed the statement merely "instructive toward the standing issue" (483 S.E.2d at 257). In *Bierman*, the Sixth Circuit addressed not imputation but whether the FDIC owed a duty to a corporation's officers and directors to mitigate damages before suing them. *See* 2 F.3d at 1427. The WVSCA's citation of the case provides no basis to conclude that it would depart from the Supreme Court's edict that "any defense good against the original party is good against" the FDIC. *O'Melveny*, 512 U.S. at 86.

4. Resorting to general policy arguments, the FDIC asserts that disallowing imputation defenses "benefits innocent third parties that ultimately bear the cost of a defendant's negligence." FB36. The WVSCA has stated unequivocally that it is "not willing to abandon the concept that where a party contributes to his own damages, he should not be able to recover for any part of them." *Bradley v. Appalachian Power Co.*, 256 S.E.2d 879, 886 (W. Va. 1979). Under the FDIC's proposed approach, however, Grant Thornton would be fully responsible for damages resulting from the failed audit even if it was only 1% at fault while Keystone was 99% at fault—a circumstance under which Grant

Thornton should not be liable at all. That result offends West Virginia law *and* policy.

Nor can such a pro-receiver regime be justified by the goal of "deterrence of auditor wrongdoing." FB37. The auditor neither selects nor oversees company management, so eliminating comparative negligence and other defenses that protect auditors from disproportionate fault will not promote management integrity or audit quality. *See Official Committee of Unsecured Creditors v. PricewaterhouseCoopers, LLP*, 989 A.2d 313, 335 (Pa. 2010) (permitting auditor to invoke imputation-based defenses against receiver "gives appropriate recognition to the fact that it is the principal who has empowered the agent and dovetails with other defenses that may be available to a negligent auditor under Pennsylvania law, in particular, those related to audit interference"). Indeed, "if the owners of the corrupt enterprise are allowed to shift the costs of its wrongdoing entirely to the auditor, their incentives to hire honest managers and monitor their behavior will be reduced." *Cenco, Inc. v. Seidman & Seidman*, 686 F.2d 449, 455 (7th Cir. 1982). Moreover, an auditor obviously lacks any control over whether a bank will survive or fail. To hold that the auditor's defenses disappear when an insolvent bank enters receivership will merely deter auditors from accepting assignments from the troubled or small banks that may benefit most from their services.

B. The Wholesale Preclusion Of Grant Thornton's Defenses May Not Be Affirmed Based On The Adverse-Interest Exception.

The FDIC places great weight on the trial court's statement—in the section of its opinion addressed to *intervening cause*—that imputation was unavailable because "management had 'abandoned' the interests of Keystone and was 'acting adversely to Keystone's interests for their own personal gain.'" FB39 (quoting Dkt. 540 at 101). The FDIC offers a six-page defense of the district court's two-sentence "holding" (FB38-44), repeatedly insisting that Grant Thornton has waived its rights because it addressed the court's brief reference to the adverse-interest exception in a footnote (GB 44 n.3). Grant Thornton did not waive any arguments. Moreover, the adverse-interest exception cannot possibly justify the district court's categorical holding that *no* management conduct may be imputed to the FDIC for purposes of establishing *any* affirmative defenses or counterclaims.

1. The FDIC's complaints regarding Grant Thornton's "perfunctory" response to the trial court's supposed "holding" regarding the adverse-interest exception are puzzling because *the application of the adverse-interest exception was not an issue that was addressed at the trial.* Well *before* the trial, the district court dismissed Grant Thornton's third-party claims and counterclaims and struck its affirmative defenses involving imputation of Keystone management's knowledge or conduct to the FDIC. *See* Dkt. 880 in 2:99-0992, at 13 ("Grant Thornton may not impute to the FDIC the knowledge or conduct of Keystone

Bank's officers[.]"); Dkt. 1044 in 2:99-0992, at 5 ("Grant Thornton is attempting to hold the FDIC, as Keystone's receiver, responsible for the misconduct of Keystone management in contravention of the prior holding of this court."); Dkt. 1060 in 2:99-0992, at 3 ("Grant Thornton has raised its affirmative defenses 5 and 7 [involving contributory negligence] in contravention of [the court's prior order]."). Grant Thornton therefore neither presented evidence relating to these imputation-related defenses at trial nor addressed the issue in its post-trial briefing. *See* Grant Thornton's Post-Trial Proposed Findings of Fact and Conclusions of Law, Dkt. 494 at 84 ("acknowledg[ing]" the district court's previous holding "that 'Grant Thornton may not impute to the FDIC the knowledge or conduct of Keystone Bank's officers'"). The Rules of Civil Procedures "require[] that a party be 'fully heard' before a judgment is rendered on a particular issue." *First Va. Banks, Inc. v. BP Exploration & Oil, Inc.*, 206 F.3d 404, 407 (4th Cir. 2000). To hold the adverse-interest exception applicable when Grant Thornton has not had the opportunity to litigate that issue would violated its due process rights.

Thus, unless this Court agrees with the district court that *Cordial* precludes all imputation of misconduct to receivers, the viability of Grant Thornton's affirmative defenses and counterclaims must be addressed by the district court on remand following the presentation of evidence and argument.

2. Contrary to the FDIC's argument, the adverse-interest exception does not absolve Keystone of responsibility for its management's audit interference. In West Virginia, the principle that acts "against the interest of the corporation" are "not imputed to the corporation" (*Clark v. Milam,* 452 S.E.2d 714, 718 (W. Va. 1994), is inapplicable to conduct that injures persons outside the corporation. The *Restatement (Second) of Agency* § 282 provides that the "adverse interest" exception is not satisfied when (1) the agent's acts "result[] in a violation of a contractual or relational duty of the principal to a person harmed thereby" (*id.* § 282(2)(a)); or (2) the agent deals with a third party who "reasonably believes him to be authorized" to conduct the business at issue (*id.* § 282(2)(b)). Consistent with the Restatement, it is well-established in West Virginia that a corporation is liable for its agent's misconduct toward third parties, even if the agent was not acting in the interests of the corporation. *See State v. Altizer Coal Land Co.,* 98 W. Va. 563 (1924); *Powers-Taylor Drug Co. v. Faulconer,* 52 W. Va. 581 (1903); *see also, e.g., Am. Soc'y of Mech. Eng'rs v. Hydrolevel Corp*., 456 U.S. 556, 566 (1982) ("a principal is liable for an agent's misrepresentations that cause pecuniary loss to a third party, when the agent acts within the scope of his apparent authority"); *Armstrong v. Ashley*, 204 U.S. 272, 283 (1907). Even the authorities cited by the FDIC confirm that "the contributory negligence of the client is a defense where it has contributed to the accountant's failure to perform the contract

and to report the truth." *Lincoln Grain*, 345 N.W.2d at 442; *accord Stratton v. Sacks*, 99 B.R. 686, 695 (D. Md. 1989), *aff'd*, 900 F.2d 255 (4th Cir. 1990) (*per curiam*).

Here, Keystone delegated to its officers the responsibility of providing information to the auditors and representing that the information was truthful and accurate; the officers then gave Grant Thornton false information, lied about having done so, and interfered with Grant Thornton's efforts to obtain accurate information from third parties. Keystone's behavior in connection with the audit violated its duties toward Grant Thornton and caused injury. "To allow [Keystone] to claim the benefit of the contract and simultaneously avoid its burdens would … disregard equity." *Int'l Paper Co. v. Schwabedissen Maschinen & Anlagen GMBH*, 206 F.3d 411, 418 (4th Cir. 2000).

3. Furthermore, there is no basis to conclude that West Virginia law precludes the imputation to Keystone of conduct by management that was designed to keep the bank open. The FDIC cites the district court's finding that "Keystone's management perpetrated the fraud in order to disguise embezzlement and permit future embezzlement" (FB39), but the inflation of the Bank's balance sheet *mainly* disguised that it had lost hundreds of millions of dollars in unprofitable securitization transactions. "A fraud by top management to misstate earnings … is not in the long-term interest of the corporation; but, like price-fixing, it profits the

company in the first instance and the company is still civilly and criminally liable." *Baena v. KPMG, LLP*, 453 F.3d 1, 7 (1st Cir. 2006).

The FDIC argues that "[l]ooting of a corporation and embezzlement are by definition *against* the interests of the corporation and trigger the exception." FB40. But no looting or embezzlement took place during the audit or afterward. The mere fact that management's efforts to hide the Bank's deep insolvency so it could continue in business (*see Baena*, 453 F.3d at 7) also disguised prior embezzlement does not preclude imputation of those actions to Keystone. *See FDIC v. Shrader & York*, 991 F.2d 216, 223 (5th Cir. 1993) ("[K]nowledge is imputed in a case of 'joint' interests even though the agent's primary interest is inimical to that of the principal."). Neither *Clifton v. Tomb*, 21 F.2d 893, 901 (4th Cir. 1927)—which merely addressed a corporation's liability for actions taken by a putative agent before the corporation was formed—nor any other case cited by the FDIC suggests that West Virginia would reject the modern "complete adversity" rule.

It is implausible that the WVSCA would deny auditors *any* affirmative defenses or counterclaims based on imputation of management misconduct to the corporation. *See Baena,* 453 F.2d at 8 ("It is not our job to make new law for Massachusetts by adopting a peculiarly narrow view of the adverse interest exception."). Even if the FDIC's reliance on the adverse-interest exception were

not procedurally invalid, therefore, that doctrine could not serve as a basis for affirming the judgment.

C. Grant Thornton May Not Be Deprived Of The Defenses Of Contributory Negligence And Fraud On The Basis That It Was Negligent.

The FDIC argues that "'an auditor [who] allegedly failed to comply with applicable professional standards' is not innocent" and "does not deserve protection through imputation." FB45 (quoting *NCP Litig. Trust v. KMPG, LLP*, 901 A.2d 871 (N.J. 2006). Under West Virginia law, however, negligence is not a defense to fraud. *See Bradley*, 163 W. Va. at 345 ("In the case of an intentional tort, contributory negligence is not a defense."). Grant Thornton cannot be deprived of fraud-based defenses on the ground that it was negligent because under West Virginia law it was innocent enough to have a claim. Grant Thornton was indeed a "victim" of Keystone's interference with the audit, and it should not have been precluded from raising defenses acknowledging Keystone's share of responsibility for the audit's failure. *See NCP*, 901 A.2d at 887 ("Auditors cannot be and should not be held liable for all corporate accounting fraud."). The cases cited by the FDIC (FB45), *NCP* and *Chait*, do not address client interference with an audit.

Finally, the FDIC contends that the contributory negligence defense is unavailable because management's acts of fraud "did not "contribute[] to [Grant

Thornton's] failure to perform the contract." FB46. In support, the FDIC contends that because "GAAS did not allow Defendant to rely on oral statements to verify the Advanta loans, any fraud with respect to such oral statements does not excuse (nor contribute to) Defendant's failure to obtain the written confirmation required by GAAS." *Id.* Because the contributory negligence defense presupposes the auditor's negligence, the allegation that Grant Thornton made a single error that prevented it from discovering the fraud does not negate the defense. Had management not provided Grant Thornton with falsified documents, made multiple misrepresentations, and arranged for Compu-Link to send a false confirmation response, Grant Thornton would never have issued the audit report. Thus, Grant Thornton plainly was entitled to present its comparative negligence defense to the factfinder. *See Bd. of Trs. v. Coopers & Lybrand,* 803 N.E.2d 460, 469 (Ill. 2003) (provision of false management representation letter sufficient to support finding of comparative negligence).

III. THE DISTRICT COURT ERRED IN GRANTING A SETTLEMENT CREDIT OF JUST $1.3 MILLION FOR KUTAK'S $22 MILLION SETTLEMENT WITH THE FDIC

The minuscule settlement credit conflicts with West Virginia law. It is undisputed that (1) Kutak, in settling with the FDIC, was released from liability for Keystone's operating losses; (2) the stipulated value of that release was $22 million; and (3) the settlement agreement did not allocate those funds among

different categories of damages. In these circumstances, the non-settling joint tortfeasor must receive a dollar-for-dollar credit equal to the full amount of the settlement. The FDIC fails to rebut our demonstration that Grant Thornton should receive a $22 million credit here.

A. When The Settlement Agreement Does Not Allocate Between Joint and Non-Joint Damages, West Virginia Law Requires A Non-Settling Joint Tortfeasor To Receive A Full Credit.

1. The FDIC knew that Kutak and Grant Thornton were jointly responsible for a single indivisible loss but failed to allocate the settlement agreement among joint and alleged non-joint damages.

The FDIC emphasizes that West Virginia law provides for a settlement credit only "where there is a *single indivisible loss* arising from the actions of multiple parties who have contributed to the loss." FB47 (quoting *Bd. of Educ. of McDowell County v. Zando, Martin & Milstead, Inc.*, 390 S.E.2d 796, 809 (W.Va. 1990) (emphasis added)). But the current dispute does not implicate "the single-indivisible-loss requirement of West Virginia law." FB52. When ordered to produce its right-to-sue memo, the FDIC was forced to concede that it viewed Kutak and Grant Thornton as jointly responsible for Keystone's operating losses and that Grant Thornton was entitled to a *pro tanto* settlement credit under West Virginia law.

Accordingly, the cases cited in the FDIC's brief (FB47), in which the courts denied a settlement credit after finding that there was *no* "single indivisible loss,"

are inapposite. *See*, *e.g., Sloane v. Equivax Info. Sys.*, 510 F.3d 495, 501 (4th Cir. 2007) (no settlement credit where plaintiff's "emotional and economic damages resulted from separate acts by separate parties"). The question here is not whether a settlement credit is warranted, but how the credit should be calculated when there is potentially joint responsibility but the plaintiff and the settling defendant did not allocate their settlement between jointly-caused damages and those caused by the settling defendant alone.[7] West Virginia law clearly requires that the defendant in these circumstances receive a full, dollar-for-dollar credit.

2. West Virginia law requires a full credit.

The FDIC contends that West Virginia law mandated the court-imposed allocation because the settlement-credit rule applies "only to the extent of the common damages." FB48. Under the FDIC's proposed rule, whenever a plaintiff settles with one of several joint tortfeasors and does not allocate the settlement among joint and non-joint damages, the court cannot apply the verdict reduction rule until "*after* the amount of the settlement covering common damages has been computed." FB53.

[7] The FDIC's brief studiously ignores why the trial court was faced with this issue. It does not dispute that it settled with Kutak *after* Grant Thornton had already sought leave to seek contribution from Kutak and that it nevertheless elected not to allocate the settlement among joint and non-joint damages. This strategy allowed the FDIC to deny any overlap between Grant Thornton's and Kutak's liability until it was ordered to produce its right-to-sue memo.

1. In fact, the UCATA's language neither anticipates nor requires the court to perform an allocation before awarding a settlement credit. Instead, Section 4 provides unconditionally that, when a plaintiff releases a party from liability for "the same injury" for which it is suing another party, the release "reduces the claim against the others to the extent of any amount stipulated by the release or covenant, or in the amount of consideration paid for it, which ever is the greater." *Zando*, 390 S.E.2d at 805 (quoting the UCATA rule). Contrary to the FDIC's argument (FB53), the statute's reference to the "same injury" merely indicates that the rule applies to settlements among joint tortfeasors; it does not require the court to allocate settlements before applying the verdict reduction rule. The FDIC's argument is contrary to *Zando.*

Indeed, the FDIC reads the UCATA as if it said that a settlement with a joint tortfeasor "reduces the claim against the others to the extent of the portion of the consideration paid that is allocated by the court to damages for which the settling and nonsettling parties are jointly liable." That is not what the statute says, and the WVSCA would never adopt such a tortured interpretation of it. *See Alaska Supreme Court Navistar Int'l Transp. Corp. v. Pleasant,* 887 P.2d 951, 958 (Alaska 1994) (UCATA "calls for a reduction [of the verdict] in the amount of the total consideration paid for the release, not merely the consideration which can be allocated to common liability").

Contrary to the FDIC's argument (FB52), moreover, Kutak undoubtedly was released from liability for "the same injury" for which Grant Thornton was held liable; and Grant Thornton therefore is entitled to have the verdict against it reduced by the "amount stipulated by" or the "amount of consideration paid for" the Kutak release. Had the FDIC allocated the settlement between the joint and non-joint damages, then it could readily have argued that the "amount of consideration paid" or the "amount stipulated" for the release of liability for the *joint* damages was less than $22 million. *Id.* Having failed to allocate the settlement—apparently in the hope of avoiding *any* credit—the FDIC should not be heard to complain about the necessary result under the UCATA.

2. In arguing that there must be an allocation before Section 4's verdict-reduction rule is followed, the FDIC points out that a West Virginia plaintiff is entitled to "one, but only one, *complete* satisfaction." FB47. In any settlement, however, a plaintiff bargains away its right to *complete* satisfaction for its losses: even if Grant Thornton received no settlement credit, the government still would not receive "full satisfaction" for the purported $300 million in damages. Moreover, West Virginia's verdict reduction principles also are driven by concerns about "avoiding double recovery for a single indivisible harm." FB58. That concern—as well as West Virginia's explicit concern about fairness to non-settling joint tortfeasors (*see, e.g., Smith v. Monanghela Power Co.*, 429 S.E.2d 643, 648

(W. Va. 1993))—is implicated by the district court's lopsided allocation of the Kutak settlement.

3. The FDIC also argues that the allocation of a settlement by the parties would be subject to manipulation. Under West Virginia law, however, a settlement that "single[s] out a non-settling defendant or defendants for wrongful tactical gain" (*Smith*, 429 S.E.2d at 652 (emphasis in original)), lacks good faith and will not extinguish the non-settling defendant's contribution claim. Thus, a settling defendant in a multi-defendant suit has every incentive "to protect non-settling parties' interest" (FB58) by insisting on a fair allocation—counterbalancing the plaintiff's incentive to maximize the total recovery by allocating the bulk of the settlement to non-joint claims.

4. Many cases hold that, when a settlement covers both joint and non-joint liabilities and does not allocate among joint and non-joint claims, "the nonsettling party is entitled to a credit equaling the entire settlement amount." *Cohen v. Arthur Andersen LLP,* 106 S.W.3d 304, 310 (Tex. Ct. App. 2003) (citing *Mobil Oil Corp. v. Ellender,* 968 S.W.2d 917, 928 (Tex. 1998)). *See* GB49-51. The FDIC contends that some (but not all) of these cases are "involve settlements that covered only the single indivisible injury for which both the settling and defendants were liable, not additional injuries for which the non-settling defendant was not liable." FB55. In every case, however, the non-settling defendants

received a full credit for settlements releasing claims for damages not included in the verdicts. For example, in *Cohen*, which according to the FDIC involves a "single injury" (FB 55), the settlement agreement "covered" both "damages for which [plaintiffs'] parents and Andersen [were] jointly liable" *and* "damages for which only [plaintiffs'] parents [were singly] liable." 106 S.W.3d 304, 310. "Because the settlement agreement d[id] not make any allocations" among the joint and non-joint damages, the court held that "Andersen [was] entitled to a credit *equaling the entire settlement amount*." *Id*. (emphasis added).

Similarly, in *Hess Oil Virgin Island Corp. v. UOP, Inc.*, 861 F.2d 1197 (10th Cir. 1988), the settlement agreement covered damages that were *not* reflected in the verdict against the non-settling defendant. *Id*. at 1208. The Tenth Circuit nevertheless refused to undertake its own post-hoc "apportionment," reasoning that "[i]f [the plaintiff] wanted to have any particular application of its settlement with the settling defendants towards [the defendant]'s liability, it should have specifically stipulated in the settlement documents what allocations of damages were applicable to each cause of action." *Id*. at 1209; *see also Friedland v. TIC-The Indus. Co.*, 566 F.3d 1203, 1210 (10th Cir. 2009) ("In *Hess Oil*, we held that the plaintiff's failure to allocate costs [among divisible harms] was fatal to its contention that the defendant was not entitled to a credit [for the full] settlement amount").

5. The sensible approach followed in these decisions is required by West Virginia law. In advancing the contrary view, the FDIC relies heavily on this Court's unpublished decision in *Bowers v. Kuse*, 1998 WL 957455 (4th Cir. 1998) (FB49–50, 54, 58). *Bowers* does *not* involve a "settlement allocation" (FB50), but instead addressed whether there were any joint damage at all: the defendant questioned "whether it was entitled to a credit or set-off for funds received by the Trustee from its settlement with" another defendant. 1998 WL 957455, at *2. In a ruling upheld as not "clearly erroneous" (*id.* at *7), "[t]he bankruptcy court "concluded as a matter of fact that the [joint] claim was not part of the settlement" at all. *Id.* at *2, *7. Although *Bowers* quotes as dictum a Ninth Circuit decision holding that the "bankruptcy court must undertake an independent allocation of the settlement" (1998 WL 957455, at *7 (quoting *In re Lendvest Mortgage, Inc.*, 42 F.3d 1181, 1185 (9th Cir. 1994)), the FDIC's assertion that our position is "directly contrary to this Court's holding in *Bowers*" (FB54) is erroneous.

Likewise, *Tazewell Oil Co., Inc. v. United Virginia Bank/Crestar Bank*, 413 S.E.2d 611 (Va. 1992)—relied on prominently by the district court (Dkt. 645 at 53)—does not, as the FDIC contends (FB51), "require[] judges to independently apportion settlements between common and unrelated damages." The court there noted simply that the trial court made no "attempt … to ascertain whether the amounts paid" for the various releases executed in that case "were based on" the

same injuries covered by the verdict. *Id*. at 613. "Without such … analysis," the court concluded, "the trial court could not determine whether the amount stipulated … was more or less than the amount actually paid." *Id*. at 622-623. The court remanded to resolve, "*if possible*, the appropriate amount of compensation for each injury" covered by the various settlement agreements. *Id*. (emphasis added). Nothing in *Tazewell* suggests, as the district court here concluded (Dkt. 645 at 48), that trial courts are "required to make an independent allocation" of settlement amounts when the allocation does not appear on the face of the agreement.

3. The post-hoc settlement-allocation proceeding was unfair.

The post-hoc allocation trial necessitated by the FDIC's favored settlement-credit rule was both inefficient and unfair. Involving costly additional discovery, written submissions, and a three-day hearing, it nevertheless had no chance of resulting in a fair allocation. To minimize Grant Thornton's settlement credit, the FDIC had every incentive to exaggerate Kutak's liability. Having no first-hand knowledge of Kutak's conduct, Grant Thornton was in no position to counter the FDIC's presentation effectively.

Failing to explain how the adversary process functioned in a proceeding that "test[ed] the amount of damages caused by Kutak" (FB57) without Kutak's participation, the FDIC instead trumpets the district court's "intimate knowledge of the case" (*e.g.*, FB10, 49). That is no substitute for a genuine adversary process.

Because the FDIC's claims against Kutak were settled before its complaint was even filed, moreover, the district court was not truly familiar with that part of the case and was in no position to judge *ex parte* the extent of damages caused by Kutak.

Furthermore, the district court's methodology was fundamentally skewed, since the overlap between Grant Thornton's and Kutak's liability would have looked far different *ex ante* than it appeared *ex post*—after Grant Thornton had driven down the FDIC's inflated damage figures by putting the agency to its proof at trial. The FDIC notes that the district court carved nearly 20% off its inflated damages figure for Kutak (FB57), but the verdict against Grant Thornton was much less than half what the FDIC initially claimed. Moreover, the court's damage figure for Kutak assumed liability for Keystone's massive securitization losses, and the trial court's allocation included no discount for the likelihood that the FDIC could have proven liability for such damages. In short, the allocation procedure was entirely unrealistic, and served only to provide a fig leaf for reducing the settlement credit to a disproportionately low 8.563%.

The FDIC's denial that the allocation process was "protracted" (FB59) rings hollow. It involved months of pre-hearing discovery, several days of trial, and extensive briefing; and the process delayed final judgment by almost two years. It is inconceivable that the WVSCA—which has recognized the problems inherent in

analyzing a settlement "in terms of its relationship to a jury verdict" (*Smith*, 429 S.E. 2d at 649)—would adopt a rule that devotes such substantial judicial and party resources to an allocation that can be made more reliably and efficiently in the settlement agreement.

4. The settlement credit should be based on the amount stipulated in the settlement agreement, not the amount actually received by the FDIC.

Section 4 of the UCATA, which *Zando* adopts, unambiguously provides that a "prior … claim" by a joint tortfeasor "'reduces the claim against the others to the extent of any amount stipulated by the release or the covenant, or in the amount of the consideration paid for it, whichever is the greater.'" *Zando*, 390 S.E. at 805 (quoting UCATA § 4). This language mandates that the credit be calculated based on the $22 million stipulated in the settlement, not the amount received by the FDIC.

The FDIC contends that $22 million is not the stipulated settlement value because Kutak itself was not liable for the entire $22 million but only "agreed to 'cooperate' with the FDIC to recover … $10 million from its insurer." FB61. The source of the stipulated funds makes no difference to the application of Section 4, however. Nor is it significant that Kutak guaranteed payment of only $15,692,521 if the insurer did not pay, since Section 4 *differentiates* between the amount stipulated and the amount paid. The FDIC and Kutak expressly agreed that the

FDIC's claims had "a total settlement value of at least $22 million" (GT Ex. 507 ¶ 29), and that is the relevant figure for purposes of calculating the settlement credit.

Grant Thornton's opening brief explains why the district court erred in relying on the construction of the UCATA offered in *Garcia v. Duro Dyne Corp.*, 67 Cal. Rptr. 3d 100, 106 (Cal. Ct. App. 2007), *Fibreboard Corp. v. Fenton*, 845 P.2d 1168 (Colo. 1993), and *Federal Sav. & Loan Ins. Corp. v. Butler*, 904 F.2d 505 (9th Cir. 1990), *see* GB57-59, and we will not repeat those arguments here. This Court should adopt the plain-language construction of Section 4 adopted in *Tommy's Elbow Room, Inc. v. Kavorkian*, 754 P.2d 243, 246 (Alaska 1988)—a case cited with approval in *Zando*—and conclude that when, as here, the amount paid is less than the stipulated settlement value, the judgment must be "reduced by the amount stipulated." *Id.*

RESPONSE TO CROSS APPEAL

SUMMARY OF ARGUMENT

The district court did not abuse its discretion in declining to award prejudgment interest to the FDIC. FIRREA authorizes the award of prejudgment interest only if (1) the damages resulted from the "improvident or otherwise improper use or investment of any insured depository institution's assets" *and* (2) prejudgment interest is otherwise "appropriate." Here, neither condition was satisfied, and prejudgment interest thus is unavailable.

The district court assumed without deciding that the damages here resulted from the "improvident or otherwise improper use or investment" of assets, and then examined whether prejudgment interest was "appropriate" by looking to West Virginia law. It did not breach its discretion by doing so. Federal courts often look to state law to determine whether prejudgment interest is appropriate, and federal common law on this subject points in the same direction as West Virginia law.

Under West Virginia law, prejudgment interest arises only for statutorily-enumerated "special damages" or for "liquidated damages." Here, the damages were not simple "out-of-pocket" expenditures, nor were they reasonably susceptible to computation by the parties based upon an established standard. Instead, the proper measure of damages was contingent on the outcome of complex legal and factual questions as well as the determination of the settlement credit. Because the damages could not be calculated until after the district court resolved these issues, neither West Virginia nor federal law permits the award of prejudgment interest here.

STANDARD OF REVIEW

The district court's decision whether to award prejudgment interest is reviewed for abuse of discretion. *See Moore Bros. Co. v. Brown & Root, Inc.*, 207

F.3d 717, 727 (4th Cir. 2000); *Gribben v. Kirk*, 466 S.E.2d 147, 150 (W. Va. 1995).

ARGUMENT

THE FDIC IS NOT ENTITLED TO PREJUDGMENT INTEREST

1. Section 1821(*l*) permits the award of prejudgment interest only when the damages are "determined to result from the improvident or otherwise improper use or investment of any insured depository institution's assets." *Id.* That precondition for obtaining prejudgment interest under FIRREA was not satisfied here because the claimed damages resulted instead from Keystone's ordinary and proper business operations. Payments for "wages and salaries of Bank employees; interest paid on CDs, IRAs, and savings accounts; office supplies, legal, consulting and accounting fees; directors' fees, utilities" (Dkt. 540, ¶ 135), and "business operating taxes" (*id.* ¶ 137) do not represent the "improvident or otherwise improper use or investment" of bank's assets.[8] Because § 1821(*l*) "specifically create[s] [a] special federal rule[] of decision regarding claims by, and defenses against, the FDIC as receiver" (*O'Melveny*, 512 U.S. at 87), the FDIC's failure to satisfy this requirement means that it may not obtain prejudgment interest here even if it would be available under state law.

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[8] The district court found it unnecessary to determine whether this condition was satisfied because it concluded that prejudgment interest was not "appropriate." Dkt. 540 at 129.

The FDIC does not deny that the "improvident or otherwise improper" use or investment of assets is a prerequisite to recovery of prejudgment interest under FIRREA. It contends that in this case, "[g]iven Keystone's insolvency, use of Keystone's assets to pay operating expenses after April 21 essentially did nothing but drain those assets." FB62. Quite obviously, however, the phrase "improper or otherwise improvident" refers to a payment that is wrongful or egregious in its own right, which the FDIC concedes was not the case here. If paying interest on legitimate deposits and taxes can support an award of prejudgment interest, then the "improper or otherwise improvident" limitation imposed by Congress has no substance. *See O'Melveny*, 512 U.S. at 88 (rejecting notion that FIRREA supports legal rules designed to avoid "depletion" of the fund). It would also permit an award of "damages" without a breach of duty.

2. Even if the damages were determined to result from the "improvident or otherwise improper" use or investment of assets, the FDIC would not be entitled to prejudgment interest. Section 1821(*l*) permits the award only of "appropriate interest." Whether to award prejudgment interest under FIRREA is a question "addressed to the equitable discretion of the trial court." *Comeau*, 810 F. Supp. at 1181. The FDIC relies on *Comeau* (PB65), but ignores its holding.

The FDIC contends that FIRREA *mandates* the award of prejudgment interest because "Congress chose the word 'shall'—not 'may'—to describe the

court's role in awarding interest." FB63. The statute construed in the case cited by the FDIC (PB64) provides that the court "shall order" forfeiture in certain cases. *See U.S. v. Monsanto*, 491 U.S. 600, 607 (1989). In contrast, § 1821(*l*) does not state that the court "shall award" prejudgment interest; it says instead that "*recoverable* damages … shall include *appropriate* interest." That language merely *authorizes* the court to determine whether prejudgment interest is appropriate; it does not *require* the court to award prejudgment interest.

To begin, "recoverable" means "capable of being recovered." *The Compact Oxford English Dictionary* 1530 (2d ed. 2000). Thus, § 1821(*l*) literally says that "the damages capable of being recovered … shall include appropriate interest." That plain language means only that the damages *may* include interest; it does not mean that the damages *must* include prejudgment interest. Further, the "recoverable damages" include only "*appropriate* interest." As the court held in *Comeau*, this language permits the award of interest "in appropriate cases." 810 F. Supp. at 1180. The FDIC contends that "Congress selected the word 'appropriate' to give courts rate-setting guidance" (FB63), but the statute says nothing about rates. Had Congress meant that "the court shall award interest at an appropriate rate," it would have said so.

3. The district court assumed (without determining) that prejudgment interest was authorized under FIRREA and then analyzed whether the award of

interest was "appropriate" by looking to state law. Contrary to the FDIC's argument (FB64), the district court did not err by doing so. In fact, in the absence of "explicit standards for the allowance of pre-judgment interest," federal statutes are treated as "incorporating the applicable state law on [the] issue." *See United States v. Am. Mfrs. Mut. Cas. Co.*, 901 F.2d 370, 372-73 (4th Cir. 1990); *see also Home Savings Bank, F.S.B. v. Gillam,* 952 F.2d 1152, 1161 (9th Cir. 1991). Consultation of state-law standards is particularly appropriate here given that the receiver's substantive claims were raised under state law. *See O'Melveny*, 512 U.S. at 87.[9]

The FDIC insists that the district court breached its discretion by "analyz[ing] whether interest was warranted under *state* law" rather than "under FIRREA." FB64. But the case cited by the FDIC involves an award of prejudgment interest *at the rate* established by state law when federal law granted discretion to award a higher rate. *See United States v. Dollar Rent A Car Sys., Inc.*, 712 F.2d 938, 941 (4th Cir. 1983). In contrast, here the FDIC "has identified *no* significant conflict with an identifiable federal policy or interest." *O'Melveny*, 512

[9] The FDIC contends that "Section 1821(l) would be superfluous if it only granted the FDIC rights that it already had under state law." FB65. As discussed above, however, that provision *limits* the provision of prejudgment interest and is not superfluous.

U.S. at 88.[10] Indeed, federal common law merely directs courts to "weigh the equities in a particular case to determine whether an award of prejudgment interest is appropriate." *Moore Bros.*, 207 F.3d at 727. Federal courts deny prejudgment interest where "a legitimate controversy existed" regarding the amounts ultimately deemed to be owed. *Id.* Because federal law points to the same conclusion as does West Virginia law, the district court did not err in applying state law.

4. The district court correctly concluded that West Virginia law forbids imposition of prejudgment interest under the circumstances of this case. In West Virginia, the prejudgment interest "rule is *of limited applicability* since it involves only pecuniary losses that are subject to reasonable calculation that exist at the time of the trial." *Bond v. City of Huntington*, 276 S.E.2d 539, 550 (W. Va. 1981) (emphasis added). Prejudgment interest is available only "if the judgment … is for special damages … or for liquidated damages." W. Va. Code § 56-6-31. "Special damages include lost wages and income, medical expenses, damages to tangible personal property, and similar out-of-pocket expenditures, as determined by the court." *Id.* The trial court exercises discretion in determining whether damages are "special" or "liquidated" and therefore qualify for prejudgment interest. *See*

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[10] The FDIC cannot support its claim to prejudgment interest on the basis that such interest is necessary to "fully compensate" it for Keystone's losses (FB66). The legal fiction that the damages here represent compensation for harm to Keystone when the bulk of the damages is interest paid to Keystone's depositors would be pushed past the breaking point by an award of "interest on interest."

State ex rel. Chafin v. Mingo County Comm'n, 434 S.E.2d 40, 44 (W. Va. 1993) (explaining that, in West Virginia, prejudgment interest is "available on 'lost wages and income, medical expenses, damages to tangible personal property, and similar out-of-pocket expenditures, *as determined by the court*'") (quoting W.Va. Code § 56-6-31; emphasis added by the court).

"[W]hen prejudgment interest is awarded as 'liquidated damages,' such interest runs from the date when the damages are of a nature to be certain or capable of being made certain by calculation and when the exact sum certain amount due is made known to the liable party." *Gribben*, 466 S.E.2d at 160. "Damages are considered certain or capable of being made certain where there is essentially no dispute between the parties concerning the basis of computation of damages if any are recoverable." *Id.* at 160 n.26. As this Court has explained (applying North Carolina law), "when the damages sought are unliquidated and cannot be readily ascertained by mere computation, or by a legal or recognized standard, [prejudgment] interest is not awarded … because the party liable could not have determined the amount owned and therefore could not be in default for not paying." *Vancouver Plywood Co. v. Godley Constr. Co.*, 393 F.2d 295, 299 (4th Cir. 1968); *see also Gerber Prods. Co. v. Fisher Tank Co.*, 833 F.2d 505, 509 (4th Cir. 1987) (no prejudgment interest under North Carolina law where the defendant "had no basis for an advance prediction with any assurance of the

amount a jury would ultimately award"); *Lockard v. City of Salem*, 43 S.E.2d 239, 243 (W. Va. 1947) ("Interest is denied when the demand is unliquidated for the reason that the person liable does not know what sum he owed, and therefore cannot be in default for not paying.") (quoting 1 *Sutherland On Damages* 1092 (4th ed. 1916)).

The FDIC does not say whether it believes the damages here qualify as "special" or "liquidated" damages under West Virginia law. It principally relies (PB68-70), however, on two cases involving "damages to tangible personal property" (*see Hardman Trucking, Inc. v. Poling Trucking Co.,* 346 S.E.2d 551, 556 (W. Va. 1986) (damage to truck); *Teter v. Old Colony Co.*, 441 S.E.2d 728, 743-44 (W. Va. 1994) (damage to retaining wall)), and one case involving out-of-pocket expenditures for housekeeping services (*see Wilt v. Buracker*, 443 S.E.2d 196, 208-09 (W. Va. 1993)). These cases—like the other cases cited by the FDIC—involve statutorily-enumerated special damages or other categories of damages that have been specifically held to support prejudgment interest under West Virginia law. *See*, *e.g., id.* at 208 (explaining that out-of-pocket expenditures for housekeeping expenses are "special damages"); *O'Neale v. Peake Operating Co.*, 404 S.E.2d 420, 423 (W. Va. 1991) ("The law allows the recovery of prejudgment interest in cases involving damage to real property where the damages are reasonably susceptible to calculation."); *Capper v. Gates*, 454 S.E.2d 54, 64

(W. Va. 1994) ($50,000 fee paid to surveyor who knowingly encouraged investors to continue work on futile development "represents the Partnership's out-of-pocket losses caused by [surveyor's] negligence and are special damages upon which prejudgment interest may be awarded"). Furthermore, the methods of calculation employed in these cases were simple and straightforward.

The cases do not support the FDIC's wishful contention that *all* "damages are special or liquidated" if "the resolution of factual disputes can be subject to the jury's 'reasonable' assessment and calculation." PB69. To the contrary, the West Virginia courts have resisted requests "to further expand the availability of prejudgment interest" to other types of cases. *Chafin*, 434 S.E.2d at 44.

5. The damages in this case were not "special" or "liquidated." There were substantial disputes about virtually every assumption concerning the calculation of damages, including the most fundamental issues about how damages should be measured. As the district court's opinion reflects (Dkt. 540 at 62-67, 117-126), Grant Thornton challenged the FDIC's entitlement to "deepening insolvency" damages in a negligence case; contended that such damages should be measured by a net worth comparison than via the FDIC's unprecedented "cash-out-the-door" method (*id.* at 64-66, 122-124); denied that the expenditures comprising the FDIC's claimed damages (such as for interest on deposits accepted prior to the audit) were proximately caused by the alleged negligence; and disagreed with the

FDIC regarding the appropriate offsets to the FDIC's ostensible losses.[11] *See In re Latin Inv. Corp.*, 168 B.R. 1, 5 (Bankr. D.D.C. 1993) (noting that "[p]roof of damages to any degree of certainty [under a deepening insolvency theory] would seem[] to pose serious problems"). The parties also disputed the period for which damages were owed, with the FDIC initially contending that Grant Thornton should pay damages beginning on October 31, 1998—months earlier than the district court ultimately ruled appropriate. Dkt. 540 at 69-72. Until the district court ruled on these issues, the damages were not "certain or capable of being made certain." *Gribben*, 466 S.E.2d at 160 n.26; *see also Miller v. Fluharty*, 500 S.E.2d 310, 325 (W. Va. 1997) (prejudgment interest unavailable on award of attorneys' fees because "that amount is unliquidated and unsettled until the circulate court issues its ruling").

[11] The FDIC suggests that its damages ultimately were calculated by simply subtracting Keystone's expenditures from its income. *See* FB68 ("Such a net difference between a company's income and its expenditures is the very calculation FDIC used here."). The reality is far more complicated. The FDIC's damages expert purported to "tally the foreseeable payments that Keystone would not have made if the Bank had ceased operations after Grant's negligence" and then subtracted "those revenues that would not have been received if the Bank had ceased operations." Dkt. 540 at 122. These revenues "included interest income on new loans originated after a damage window, increased interest income from short term investment of newly received deposits, and bank operation revenues after a damage date such as loan underwriting fees, check cashing fees, safety deposit box rentals, and the like." *Id.* He excluded "[i]tems such as interest income on loans originated before a liability date and distributions from the prior existing securitization transactions … because those revenues would have been … received whether or not the Bank closed." *Id.* He did not include "all changes in Keystone's asset values, as Grant Thornton suggest[ed] he should." *Id.*

Even after the district court decided the issues of liability and damages, there remained a substantial dispute about the amount of the settlement credit owed to Grant Thornton. Until the court resolved this dispute, Grant Thornton did not know how much it owed. Thus, this dispute alone—which delayed the judgment by *more than three years*—would make the award of prejudgment interest inappropriate. *See In re J.T.R. Corp.*, 958 F.2d 602, 608 (4th Cir. 1992) (finding damages not "readily ascertainable" where "damages were not determined for more than seven years" and "the amount ultimately due to the Trustee was reduced considerably by the credit allowed to Hartford for the payment to Fidelity"); *see also Wichita Fed. Sav. & Loan Ass'n v. Black*, 781 P.3d 707, 721 (Kan. 1989) ("[T]he amount of damages could not possibly have been liquidated until the issue of offset was determined."); *Hepper v. Triple U. Enters, Inc.*, 388 N.W.2d 525, 531 (S.D. 1986) (prejudgment interest inappropriate where damages award subject to unliquidated offset).

The FDIC contends that prejudgment interest was mandatory because the court found "quantification of Keystone's damages" to be "reasonable and proper" (PB67 (quoting A126)). In every case in which damages are awarded, however, the fact-finder ultimately accepts some means of computing them. That does not render the damages "capable of being made certain by calculation" (*Gribben*, 466 S.E.2d at 160) for purposes of awarding prejudgment interest. Although Grant

Thornton does not advocate a "'general rule' against awarding prejudgment interest in accounting malpractice cases" (PB66), such an award was correctly denied here, and it certainly was within the discretion of the district court here to do so.

CONCLUSION

The judgment of the district court should be reversed.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

Pursuant to Fed. R. App. P. 32(a)(7)(C), the undersigned counsel for Appellant–Cross-Appellee Grant Thornton LLP certifies that this brief:

(i) complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because it contains 13,935 words, including footnotes and excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii); and

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CERTIFICATE OF SERVICE

The undersigned counsel for Appellant–Cross-Appellee Grant Thornton LLP certifies that on October 13, 2010, the foregoing Proof Response/Reply Brief for Grant Thornton LLP was served on all parties or their counsel of record through the CM/ECF system if they are registered users or, if they are not, by serving a true and correct copy at the addressee listed below:

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