NORTH CAROLINA

WAKE COUNTY

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION
05 CVS 2500

HARCO NATIONAL INSURANCE COMPANY,
Plaintiff

v.

GRANT THORNTON LLP,
Defendant

[AMENDED]
HARCO NATIONAL INSURANCE COMPANY'S AMENDED BRIEF IN SUPPORT OF ITS AMENDED MOTION FOR A CHOICE OF LAW DETERMINATION

Plaintiff Harco National Insurance Company ("Harco" or "Plaintiff") files this brief in support of its amended motion for a choice of law determination, pursuant to the General Rules of Practice and Procedure for the North Carolina Business Court and the Second Amended Case Management Order ("CMO") entered in this case on September 15, 2008.

Statement of the Case

On February 23, 2005, Harco filed claims against Grant Thornton, LLP ("GT") for negligence and negligent misrepresentation with regard to its audit of the balance sheet for Capital Bonding Corporation ("CBC") as of December 31, 2000, and for its audit of CBC's financial statements as of and for the year ending December 31, 2001. On October 15, 2008, Harco filed its motion and supporting brief to add claims against GT for gross negligence and fraud.

The parties are not in agreement as to which state's substantive law applies to the claims in this lawsuit. (See CMO Sec. IV A. "The case will also require resolution of certain choice of law issues. The parties are not in agreement as to the applicable substantive law."). GT asserts that Illinois law applies to Harco's claims. (See GT's Resp. Br. in Opp'n to Pl.'s Mot. for Leave to File Its Second Am. Compl. n. 2; GT's Motion to Stay p. 4). Harco asserts that either North Carolina or Pennsylvania law applies to Harco's claims (See Mem. in Opp'n to Def.'s Mot. to

Dismiss). The law regarding accounting liability, and specifically the standard regarding when accountants can be liable to a third party, is essentially the same in Pennsylvania and North Carolina but is different in Illinois.

The Different Standards Regarding Accountant Third Party Liability

Pursuant to North Carolina law as established by the Supreme Court in *Raritan River Steel Co. v. Cherry, Bekaert & Holland*, 322 N.C. 200, 367 S.E.2d 609 (1988), a third-party may recover from accountants for their negligent audit of financial statements. *Raritan River Steel Co. v. Cherry, Bekaert & Holland*, 322 N.C. 200, 367 S.E.2d 609 (1988); *see also Marcus Brothers Textiles, Inc. v. Price Waterhouse, LLP*, 350 N.C. 214, 513 S.E.2d 320 (1999), *Jefferson-Pilot Life Ins. Co. v. Spencer*, 110 N.C. App. 194, 429 S.E.2d 583 (1993). In *Raritan* the court adopted Section 552 of the Restatement (Second) of Torts which states:

> (1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.
>
> (2) . . . [T]he liability stated in Subsection (1) is limited to loss suffered
>
> (a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and
>
> (b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.

Restatement (Second) of Torts § 552 (1977), *Raritan*, 322 N.C. at 209, 367 S.E.2d at 614.

In its application of Section 552 of the Restatement (Second), the North Carolina Supreme Court determined that liability of an accountant extends not only to those with whom the accountant is in privity, but also to those persons whom the accountant knows his client intends to rely on the accountants' opinion. *Raritan*, 322 N.C. at 214, 367 S.E.2d at 617.

Further, an accountant does not have to be informed by the client of the audit's intended use. *Id.* at 215, 367 S.E.2d at 618, *NCNB Nat'l Bank of North Carolina v. Deloitte & Touche*, 119 N.C. App. 106, 112, 458 S.E.2d 4, 8 (1995). The accountant only needs to have knowledge that the client is going to supply the information to a limited group of persons. *Id.*

Pennsylvania law is very similar to North Carolina's law on this issue. Though it was not clear in 1999 if Pennsylvania would apply Section 552 of the Restatement (Second) of Torts, the Middle District of Pennsylvania, in anticipating the Pennsylvania Supreme Court would adopt Section 552 of the Second Restatement as it had adopted Section 552 of the First Restatement, affirmatively cited *Raritan* and determined that privity is not needed in an accountant negligent misrepresentation claim under Pennsylvania law. *Williams Controls, Inc. v. Parente*, 39 F. Supp. 2d 517, 527, 534 (M.D. Penn. 1999). In 2005, the Pennsylvania Supreme Court did explicitly adopt Section 552 of the Restatement (Second) of Torts and held that privity is not necessary to support a claim for negligent misrepresentation. *Bilt-Rite Contr. Inc. v. The Architectural Studio*, 866 A.2d 270, 285 (Pa. 2005). Though *Bilt-Rite* is not an accountant negligent misrepresentation case, it can be assumed that the Supreme Court would apply Section 552 in an accountant negligent misrepresentation case as well. Therefore, there is no conflict between Pennsylvania and North Carolina law regarding accounting liability.

If the Court determines that Pennsylvania is the choice of law for this matter, there is no conflict of law issue because the law of accounting liability is the same in both North Carolina and Pennsylvania. When the law does not differ between two states, then it does not matter which state's law is applied. *Arnold v. Ray Charles Enter.*, 264 N.C. 92, 96-97, 141 S.E.2d 14, 17 (1965) (finding that New York and Virginia law were not different in reference to the substantive question at issue, and, thus, there was no need for the court to engage in a highly complex and confused area of conflict of laws analysis). Likewise, there is no harm in applying

the forum state's laws on a substantive issue when the law does not conflict with other connected states' laws. *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 816 (1985). These types of scenarios are often termed "false conflicts." 16 Am. Jur.2d Conflict of Laws § 135 (2008).

However, there is a conflict of law between North Carolina or Pennsylvania law and Illinois law for accountant negligence. Unlike North Carolina, Illinois has adopted a statutory provision that limits the circumstances under which auditors licensed or authorized to practice under the 1986 Illinois Public Accounting Act (the "Accounting Act") may be held liable for their negligent acts to third parties. The Accounting Act, Section 30.1 provides:

> No person, partnership, corporation, or other entity licensed or authorized to practice under this Act or any of its employees, partners, members, officers or shareholders shall be liable to persons not in privity of contract with such person, partnership, corporation, or other entity for civil damages resulting from acts, omissions, decisions or other conduct in connection with professional services performed by such person, partnership, corporation, or other entity, except for:
>
> (1) such acts, omissions, decisions or conduct that constitute fraud or intentional misrepresentations, or
>
> (2) such other acts, omissions, decisions or conduct, if such person, partnership or corporation was aware that *a primary intent* of the client was for the professional services to benefit or influence the particular person bringing the action; provided, however, for the purposes of this subparagraph (2), if such person, partnership, corporation, or other entity (i) identifies in writing to the client those persons who are intended to rely on the services, and (ii) sends a copy of such writing or similar statement to those persons identified in the writing or statement, then such person, partnership, corporation, or other entity or any of its employees, partners, members, officers or shareholders may be held liable only to such persons intended to so rely, in addition to those persons in privity of contract with such person, partnership, corporation, or other entity.

225 ILCS 450/30.1 (emphasis added). If the Accounting Act applies, Harco must prove either that the conduct constitutes fraud or intentional misrepresentation or that GT was aware that CBC had a primary intent in hiring GT in order for GT's audits to benefit entities such as Harco. While the statute appears to require that there be proof of a writing to establish that fact, recent case law has clarified that no such writing is required. *Freeman, Freeman and Salzman,*

P.C. v. Lipper, 812 N.E.2d 562, 565 (349 Ill. App. 1 Dist. 2004), *Chestnut Corp. v. Pestine, Brinati, Gamer, LTD*, 667 N.E.2d 543, 547 (Ill. App. 1 Dist. 1996).

However, even if this Court finds that Illinois is the choice of law in this matter, the Court will still have to determine whether the Accounting Act applies or whether Illinois common law applies.[1] The GT accountants, who performed the work on the CBC audits, performed the audits in Pennsylvania and were licensed in Pennsylvania, not Illinois. The Illinois statute only applies to persons licensed to practice accounting in the state of Illinois. The GT auditors cannot seek the protection of this statute without having borne the burdens of licensure and regulation in the state of Illinois. A finding that the Illinois Accounting Act applies to this case would not only be an incorrect finding under existing North Carolina law but would give the Accounting Act an extra territorial effect that would potentially raise constitutional questions.[2]

As the standard for accountant negligence is different in North Carolina and Pennsylvania than Illinois, the determination of which state's substantive law applies to this matter is a significant issue and, therefore, the Case Management Order anticipated a choice of law motion by the parties. (CMO IV D). In order for the Court to make its choice of law determination which will determine the duty of accountants to third parties, Harco herein provides the facts and circumstances around this case and the relationship of the facts to North Carolina, Pennsylvania

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[1] If Illinois common law applies, then there is still a conflict of laws as although Illinois has adopted Section 552 of the Restatement (Second) of Torts, *Rozny v. Marnul*, 250 N.E.2d 656, 662-63 (Ill. 1969) (adopting Section 552 of the draft version of Restatement (Second)), *Rankow v. First Chicago Corp.*, 870 F.2d 356 (7th Cir. 1989) (discussing the seminal case of *Rozny* and other Illinois decisions following Section 552), the Appellate Court of Illinois, Second District, in *Brumley v. Touche, Ross & Co.*, 463 N.E.2d 195 (Ill. App. 2 Dist. 1984) and *Brumley v. Touche, Ross & Co.*, 487 N.E.2d 641 (Ill. App. 2 Dist. 1985) set a higher threshold for accounting negligent misrepresentation claims than the Restatement (Second) standard. The *Brumley* decisions came before the enactment of the Accounting Act.

[2] This constitutional question is similar to one this Court avoided in *First Union Corp. v. Suntrust Banks, Inc.*, 2001 WL 1885687, *3, 2001 NCBC 7 (N.C. Super. 2001) (finding that "the use of Georgia's unfair competition or antitrust laws to contest the validity of provisions in a North Carolina merger agreement which raises quintessential corporate governance issues under North Carolina law is problematic at best and, perhaps, unconstitutional").

and Illinois. Harco then provides the Court with the choice of law tests and case law regarding those tests in order for the Court to make its decision.

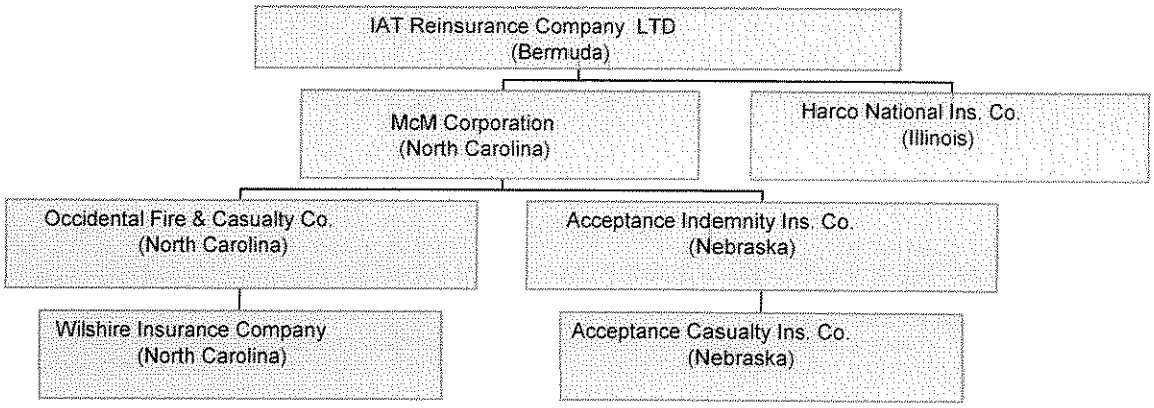
Facts

I. Harco Background Information.

Harco is a member of the IAT Group of Insurance Companies ("IAT Group") owned by IAT Reinsurance Company Limited ("IAT"). (Campbell Aff., Ex. A, pp. 12-14 ll. 21-2).[3]

As of the date of filing of the complaint in this case, the IAT Group consisted of five property and casualty insurance companies, and McM Corporation ("McM"), an insurance services company, all owned either directly or indirectly by IAT. (Stephano Aff. ¶ 3). IAT owns almost all of the stock of McM, a North Carolina corporation. (Id. at ¶ 4). McM owns Occidental Fire & Casualty Company of North Carolina, a North Carolina domiciled property and casualty insurer, which in turn owns Wilshire Insurance Company, also a North Carolina domiciled property and casualty insurer. (Id. at ¶ 4). McM also owns Acceptance Indemnity Insurance Company, a Nebraska domiciled property and casualty insurer, which in turn owns Acceptance Casualty Insurance Company, also a Nebraska domiciled property and casualty insurer. (Id.). IAT also owns Harco National Insurance Company, an Illinois domiciled property and casualty insurer. (Id.). The following is an illustration of the ownership structure of the insurance companies within the IAT Group as of February 2005 and a listing of each company's state of incorporation.

[3] The affidavits of Ashley Huffstetler Campbell, and exhibits attached thereto, David G. Pirrung and Stephen L. Stephano referenced in this brief were filed on November 25, 2008 with Harco's original motion for a choice of law determination and are incorporated herein.



IAT is domiciled in Bermuda and has offices in New York and North Carolina. (Id. at ¶ 5; Campbell Aff., Ex. B, p. 11 ll. 14-22). The IAT Group's corporate functions are located in North Carolina. (Campbell Aff., Ex. B, p. 14 ll. 11-13).

The employees for all of the insurance companies, including those who do work associated with Harco, are employees of McM Corporation ("McM"). (Campbell Aff., Ex. A, p. 24 ll. 14-15). None of the insurance companies, including Harco, have any employees. All decisions and actions taken on behalf of Harco are taken by employees of McM. (Id. at pp. 24-25 ll. 1-10).

IAT purchased Harco effective November 30, 2001 from Navistar Financial ("Navistar"), Harco's previous parent. (Stephano Aff. ¶ 6). Prior to that date, all employees who performed work for Harco were employees of Navistar. (Id.). On the date of IAT's acquisition of Harco, all Harco-related Navistar employees were terminated. (Id.). On the following day, those employees became employees of MCM corporation. (Id.).

At the time of IAT's purchase of Harco, Harco operated primarily from its Illinois office selling trucking insurance. (Stephano Aff. ¶ 7). But, after the acquisition, Harco's corporate functions were transferred to Raleigh, North Carolina. (Campbell Aff., Ex. B, pp. 335-336 ll. 12-3). On the date of acquisition, Stephen Stephano, the President of each of the IAT Group

subsidiaries and a resident of Raleigh, became Harco's CEO. (Stephano Aff. ¶¶ 9, 12). Michael Blinson in Raleigh was named Secretary. (Id. at ¶¶ 11-12). David Pirrung in Raleigh became Treasurer later in May 2002. (Id. at ¶ 10). David Kimpel in Illinois was named Harco's CFO. (Id.). Stephano, Pirrung and Blinson all work from Harco's Raleigh office. (Id. at ¶ 12).

While some business functions remained in Illinois, the primary business functions were transferred to Raleigh. (Campbell Aff., Ex. B, pp. 335-336 ll. 12-10, 572-573 ll. 22-13). Stephano immediately began exercising executive authority. (Id. at pp. 573-574 ll. 22-13). In May 2002, the Raleigh office began handling investments and accounting for investments. (Stephano Aff. ¶ 10). While Kimpel continued to handle many of the functions related to finance, treasury and accounting, he reported to Blinson in Raleigh. (Id.). Over time, much of Kimpel's work transferred to Raleigh. Harco's ledger system and investments systems were moved to Raleigh in 2003. (Id.). Harco's corporate secretarial work and corporate legal work is handled in Raleigh. (Id. at ¶ 11). IT and human resources functions are based in Raleigh. (Id. at ¶ 11). Regulatory work is handled by employees in Illinois and North Carolina. (Id.). Harco maintains bank accounts in North Carolina and Illinois as well as other states. (Campbell Aff., Ex. A, p. 383 ll. 15-23; Pirrung Aff. ¶ 6). In its Annual Statements filed with the Illinois Department of Insurance, Harco has identified Illinois as its statutory home office and main administrative office for all years since the purchase. (Campbell Aff., Ex. C).

II. Harco's Involvement with CBC.

In late December 2001, Harco's reinsurance unit located in Rolling Meadows was approached by a broker to take a small position as a reinsurer in the CBC business. After investigating the opportunity, Harco agreed to be a reinsurer for the 2002 treaty year.[4]

[4] While Harco incurred losses related to its participation in the CBC program in 2002, those losses are not the subject of the suit against Grant Thornton. Harco did not rely upon the Grant Thornton audited financial statements when it made the decision to participate in the CBC program as a reinsurer in 2002.

In October 2002, the President of CBC approached Stephano and asked if one of the IAT companies would be interested in taking over as the issuing carrier for 2003. (See, e.g., Campbell Aff., Ex. D, pp. 46-48 ll. 11-15). Stephano had two of his top executives investigate the opportunity: Ken Coon, the Director of the IAT Specialty Unit and Senior Vice President for several IAT companies, located in Omaha, Nebraska and Pirrung, from Raleigh, who was the Vice President and Treasurer of each of the insurance units. (Id.; Pirrung Aff. ¶ 8). Coon and Pirrung traveled to Reading, Pennsylvania, met with key people at CBC, obtained two GT audit opinions of CBC's financial statements for years ending 2000 and 2001, and generally investigated the opportunity. (See, e.g., Campbell Aff., Ex. D, pp. 46-48 ll.11-15).

Coon and Pirrung returned, respectively, to Omaha and Raleigh and performed a detailed review of the two GT audit opinions. (Campbell Aff., Ex. D, pp. 47-48 ll. 23-15; Ex. A, pp. 124-125 ll. 8-21). Stephano also reviewed the opinions in Raleigh. (Campbell Aff., Ex. B, p. 353 ll. 5-18). After further investigation and consultation, and in reliance on the information contained in the audited financial statements, Stephano made the decision that Harco would become the issuing carrier for CBC for 2003. (Campbell Aff., Ex. B, p. 137 ll. 10-17, pp. 272-273 ll. 6-4). Harco was chosen because it was the only company in the IAT Group with a treasury listing that would allow it to write INS and federal court bonds. (Campbell Aff., Ex. D, p. 404 ll. 10-12). In further reliance on the GT audited statements, Stephano made the decision to retain 25% of the risk and to reinsure the remaining 75% with unaffiliated reinsurers. (Campbell Aff., Ex. B, pp. 350-354 ll. 22-20).

Effective January 1, 2003, Harco and CBC entered into a Program Administrator Agreement ("PAA"), which set forth the rights and responsibilities of both parties. (Campbell Aff., Ex. E). Specifically, the PAA required that CBC provide annual audited financial

statements to its issuing carrier. (Id.). Pennsylvania law governed the contract. (Id.). The PAA identified Harco's principal place of business as Rolling Meadows, Illinois.[5] (Id.).

Harco monitored the CBC business from Raleigh and Nebraska. Pirrung, in Raleigh, was the day to day contact person with CBC, while Coon, in Nebraska, was responsible for overseeing the program. (Campbell Aff., Ex. D, pp. 35 ll. 6-14, 80 ll. 11-19). On a monthly basis, CBC transmitted reports to Pirrung, which allowed Harco to monitor the penal liability of bonds written, the amount CBC was required to deposit in the Build Up Fund account and the premium amounts due to Harco. (Campbell Aff., Ex. A, pp. 663-665 ll. 2-6; Pirrung Aff. ¶ 7). The reports were also transmitted to administrative employees in Rolling Meadows so that the information could be entered into Harco's systems. (Id.). The Rolling Meadows employees were also involved in the licensing and regulatory functions of the program. (Campbell Aff., Ex. A, p. 529 ll. 15-20, Ex. D, pp. 34-35 ll. 22-2). They worked with state departments of insurance to license bail bond agents and received and transmitted regulatory correspondence about the program to Pirrung in Raleigh for handling. (See, Campbell Aff., Ex. F; Ex. A, pp. 303-304 ll. 25-8). CBC also sent premium payments for the program to Harco's Rolling Meadows office. (Campbell Aff., Ex. G, pp. 121-122 ll. 19-16). CBC wrote bonds on Harco paper in states throughout the country, including North Carolina. (Pirrung Aff. ¶¶ 5, 7). Below is a listing of the five states for which there was the largest penal liability written and the largest amounts paid to courts by Harco on CBC bonds. (Id. at ¶ 7).

[5] Harco has also filed certain pleadings for various bail bond and other matters related to the CBC program, which identify Rolling Meadows, Harco's statutory domicile, as its principal place of business.

STATE	PENAL LIABILITY	AMOUNT PAID
CA	$122,512,469	$11, 586, 951
CT	$49,872,761	$4,938,100
NC	$90,423,427	$15,162,614
NJ	$502,602,020	$27,841,772
PA	$85,707,900	$2,716,274

CBC did not write any Harco bonds in Illinois, and Harco paid no losses to that state. (Id. at ¶ 3).

In early 2004, Harco paid its first loss on CBC bail bonds as an issuing carrier.[6] (Pirrung Aff. ¶ 4). This loss was sustained in North Carolina when the North Carolina Department of Insurance seized Harco's statutory deposits from its North Carolina trust account for bonds written and breached in North Carolina. (Id.; Campbell Aff., Ex. A, p. 382 ll. 10-19).

Harco participated with other carriers in establishing Surety Administrators, Inc. ("SAI"), which was formed to perform the run off of CBC bonds. Harco, through SAI, paid losses in thirty-eight states. (Pirrung Aff. ¶ 5). Harco paid more losses in North Carolina than in any other state, except New Jersey. (Id.; Campbell Aff., Ex. A, p. 843 ll. 9-14). Funds that were ultimately used to make the payments came from several sources. (Pirrung Aff. ¶ 6). Some funds came from an IAT Goldman Sachs account in New York. (Id.). They were transferred to an IAT account at Harris Bank in Illinois and then to a Harco Northern Trust account in Illinois. (Id.). From those accounts, the funds were transmitted to an SAI Wachovia Bank account in Reading, Pennsylvania where payments were made to courts and others involved in the mitigation effort. (Id.; Campbell Aff., Ex. B, pp. 412-413 ll. 22-25). Finally, funds from a

[6] Harco paid a loss in October 2003 as a reinsurer of the 2002 treaty year. Again, Harco is not seeking in this lawsuit any damages arising out of its role as a reinsurer for 2002.

Harco BB&T account and from a Harco Wachovia account, both in North Carolina, were used to make some payments. (Pirrung Aff. ¶ 6).

All of the financial decisions made as a result of the losses incurred by Harco on the CBC program have been made by Stephano, Coon, Pirrung and other McM employees. (See e.g., Campbell Aff., Ex. A, pp. 358-360 ll. 23-13, 378-380 ll. 15-3, 887 ll. 17-24; Ex. D, pp. 96 ll. 15-22, 102 ll. 9-19, 103 ll. 21-24).

III. GT's Involvement with CBC.

GT is an LLP organized and existing under the laws of the state of Illinois. (Campbell Aff., Ex. J, ¶ 1). GT has fifty offices in the United States, including offices in Wake County, North Carolina. (GT Answer to Compl. ¶ 2). GT regularly conducts business in North Carolina and Pennsylvania. (Id.; see also Campbell Aff., Ex. J).

In May 2001, CBC entered into a relationship with GT whereby GT agreed to audit CBC's balance sheet as of December 31, 2000. (Campbell Aff., Ex. H). GT later agreed to audit CBC's financial statements as of and for year ended December 31, 2001. (Campbell Aff., Ex. J, ¶ 3). GT's Philadelphia, Pennsylvania office conducted both audits of CBC. (Id. at ¶¶ 4, 5). The auditors who performed the audit worked in the GT Philadelphia, Pennsylvania office. (Id. at ¶ 6). There was no auditor on the engagement team for either year that was licensed in Illinois. (Campbell Aff., Ex. I).

Argument

GT claims that Illinois law applies to this case because Harco's alleged headquarters are in Illinois and, therefore, the economic impact to Harco in this matter occurred in Illinois. (See GT's Mot. to Stay p. 4; GT's Resp. Br. in Opp'n to Pl.'s Mot. for Leave to File Its Second Am. Compl. n. 2). However, Illinois has no connection to the audit that GT performed for CBC or the auditors who performed the audit. Further, Illinois has very little connection with Harco's

reliance on GT's audit, Harco's decision to enter the PAA with CBC, Harco's monitoring of the CBC program, or Harco's injury. As discussed *infra*, pursuant to the conflict of laws tests, North Carolina law applies to Harco's claims of negligence, negligent misrepresentation, gross negligence and fraud.

I. The Two Conflict of Laws Tests

The choice of law analysis determines which state's laws apply to the substantive claims at issue. North Carolina courts apply both the Restatement (First) of Conflict of Laws ("First Restatement") and the Restatement (Second) of Conflict of Laws ("Second Restatement") approaches. The First Restatement and Second Restatement have two different approaches to the analysis of a choice of law issue. No North Carolina court has made a choice of law determination regarding negligent or fraudulent accounting claims.[7]

Under the First Restatement, the state that is the place of the wrong is the state whose laws apply to the claims at issue, the *lex loci delecti* test. "The place of wrong is in the state where the last event necessary to make an actor liable for an alleged tort takes place." Restatement (First) of Conflict of Laws § 377 (1934).

The majority of states have abandoned the *lex loci delecti* choice of law rule for the most significant relation test as set out in the Second Restatement. 16 Am. Jur.2d Conflict of Laws § 124; *see also*, *United Dominion Indus. Inc. v. Overhead Door Corp.*, 762 F. Supp. 126, 128 (W.D.N.C. 1991) (noting that the more modern rule in conflict of law analysis is the most significant relationship test). Pursuant to the Second Restatement, "the rights and liabilities of the parties with respect to an issue in tort are determined by the local law of the state which, with respect to that issue, has the most significant relationship to the occurrence and the parties under the principles stated in § 6." Restatement (Second) of Conflict of Laws § 145.

[7] Two cases which have considered the choice of law question for negligent accounting are *Rhode Island Hosp. Trust Nat'l Bank v. Swartz*, 455 F.2d 847 (4th Cir. 1972) and *Rusch Factors, Inc. v. Levin*, 284 F.Supp. 85 (D.C. R.I. 1968).

Under either test, North Carolina law governs the claims in this matter.

II. North Carolina Law Applies Under the First Restatement's Approach of *Lex Loci Delecti.*

In *Boudreau v. Baughman*, 322 N.C. 331, 368 S.E.2d 849 (1988), the Supreme Court stated

> Our traditional conflict of laws rule is that matters affecting the substantial rights of the parties are determined by lex loci, the law of the situs of the claim, and remedial or procedural rights are determined by lex fori, the law of the forum. For actions sounding in tort, the state where the injury occurred is considered the situs of the claim. Thus, under North Carolina law, when the injury giving rise to a negligence or strict liability claim occurs in another state, the law of that state governs resolution of the substantive issues in the controversy.

Boudreau, 322 N.C. at 335-36, 368 S.E.2d at 853-54. Thus, since the injury in *Boudreau* occurred when plaintiff, a resident of Massachusetts, injured his foot on the metal surface of a chair while visiting friends in Florida, Florida law applied. *Id.* at 332, 368 S.E.2d at 852.[8]

Determining the state where the injury occurred in a personal injury matter such as *Boudreau* is an easier analysis than determining the state where the injury occurred in a commercial action such as occurred to Harco. *See United Dominion Indus., Inc. v. Overhead Door Corp.*, 762 F. Supp. 126, 129 (W.D.N.C. 1991) ("It is generally clear where someone sustains an injury in [personal injury] cases. However, in a commercial action such as this one, determining the place that the injury occurred is not especially self-evident."). To determine where an injury occurred in a commercial action, some courts look to the place where the injury is sustained while other courts look to where the last event occurred which gave rise to the claim. North Carolina is the place where the injury occurred in this case under either analysis: It is both

[8] The Supreme Court decided to use the *lex loci delecti* test for the personal injury claim in *Boudreau* because it was "an objective and convenient approach which continues to afford certainty, uniformity, and predictability of outcome in choice of law determinations." *Id.* at 336, 368 S.E.2d at 854. However, in determining the choice of law rule for plaintiff's breach of warranty claim under the UCC, the Court applied the significant relationship test. *Id.* at 338, 368 S.E.2d at 855. Thus, it is not clear that the North Carolina Supreme Court would apply the *lex loci delecti* test in a business tort context where the rule does not provide such an easy determination.

where the injury was sustained and where the last act occurred giving rise to its claim against GT.

A. Where Injury Sustained

Following the rule of *lex loci delicti*, the injury occurs where the last event takes place to render the actor liable. In a tort claim, the last element is injury, and, thus, many courts have concluded that where the injury is sustained determines which state's substantive law is applied. *Stetser v. Tap Pharm. Prods., Inc.*, 165 N.C. App. 1, 14-15, 598 S.E.2d 570, 580 (2004) (remanding class certification issue for determination of the state law to be applied to the tort claims as the class was a nationwide plaintiffs' class with injuries thus sustained in various states); *Lormic Dev. Corp. v. North American Roofing Co.*, 95 N.C. App. 705, 710-11, 383 S.E.2d 694, 697 (1989) (applying South Carolina law regarding the duty to foreseeable users to negligence action involving damage from the roof installed on shopping center located in South Carolina); *Gbye v. Gbye*, 130 N.C. App. 585, 586, 503 S.E.2d 434, 435 (1998) (applying Alabama law, which recognizes the doctrine of parental immunity, to wrongful death action involving automobile accident which occurred in Alabama); *Speedway Promoters, Inc. v. Hooter's of America, Inc.*, 123 F. Supp. 2d 956 (W.D.N.C. 2000) (applying North Carolina law to case where injuries for a tortuous interference with contract claim were sustained in North Carolina when the plaintiff was ordered to cease distribution of racing collectibles in North Carolina); *Gregory Wood Prods. v. Advanced Sawmill Mach. Equip. Inc.*, 2007 WL 1825179, *7 (W.D.N.C. June, 2007) (finding that injuries for negligent misrepresentation and negligent design were sustained in North Carolina, the location where the equipment failed to perform to plaintiff's expectations).

To determine where a company sustained injury from business torts such as in this matter is conceptually difficult and not generally self-evident. *See United Dominion Indus., Inc. v.*

Overhead Door Corp., 762 F. Supp. at 129. Harco writes insurance in 49 states. It has its statutory office in Illinois, and its executive office in North Carolina. The employees who do work on behalf of Harco are MCM employees, a North Carolina corporation. The CBC program was run out of Reading, Pennsylvania and monitored by Harco in North Carolina and Nebraska. All of Harco, its parent company and its senior management sustained injury throughout the United States.

However, Harco felt the injury first and most severely in North Carolina. In 2004, Harco sustained its first loss when it paid losses on bonds written and forfeited in North Carolina. The North Carolina Department of Insurance seized Harco's statutory deposits from its North Carolina trust account to pay the losses. Further, the injury was felt most strongly in North Carolina because its corporate offices are located in North Carolina and most of its top management is located here. To the extent Harco incurred losses on the CBC program, those losses affected the Insurance Business Group ("IBG") compensation plan for all executives receiving compensation through the plan. (Pirrung 114:23-115:7; Coon 416:2-17; 255:3-15). These executives are located all over the United States, but more executives are located in North Carolina than any other state. (Pirrung Aff. ¶ 7). Further, these executives are all employed by MCM, a North Carolina corporation. Thus, to the extent the injury to Harco must be determined to be in one state, that state is North Carolina.

B. Where Last Event Necessary Occurred

A slight variation of the rule of *lex loci delicti* and "where the injury is sustained" asks where the last event necessary to give rise to the claim occurred. Two North Carolina Court of Appeals cases seem to follow this rule.

In *Lloyd v. Carnation Co.*, 61 N.C. App. 381, 301 S.E.2d 414 (1983), a territorial distributor of bull semen brought a claim against defendants for unfair and deceptive trade

practices under the North Carolina general statutes for forcing plaintiff out of the territories of Virginia, North Carolina and South Carolina. *Lloyd v. Carnation Co.*, 61 N.C. App. 381, 301 S.E.2d 414 (1983). The Court of Appeals affirmed the trial court's dismissal of the unfair and practices claim, finding that Virginia law applied and Virginia did not have a similar statute. *Id.* at 387-88, 301 S.E.2d 418. The court determined that the last wrongful act upon which the claim was based, the selling of the semen between the defendants, took place in Virginia. *Id.* Further, the court noted that all of the defendants' acts were done entirely in Virginia. For instance, all of the meetings and discussion between plaintiff and defendants took place in Virginia, and of the three states, Virginia was where the defendant allegedly sold semen to a competitor. *Id.*

The Court of Appeals, citing *Lloyd*, again used the last act giving rise to the injury rule in *United Virginia Bank v. Air-Lift Assoc.*, 79 N.C. App. 315, 339 S.E.2d 90 (1986). United Virginia Bank brought an action seeking deficiency judgment on a promissory note for an airplane, which defendants had executed. *Id.* The plane was turned over to the bank in North Carolina. Defendants counterclaimed for unfair and deceptive trade practices and breach of fiduciary duty under North Carolina General Statutes because one of the defendant guarantors had offered to pay $100,000 for the aircraft, but the bank refused to sell to him because he was a guarantor. *Id.* at 316, 339 S.E.2d at 91. Instead, the bank had the plane flown from the Raleigh-Durham Airport in North Carolina to an airport in Richmond, Virginia where it sold at a public sale for $55,000. *Id.* at 316-17, 339 S.E.2d at 91. The Court of Appeals found that the last act giving rise to defendants' claim for unfair and deceptive trade practices occurred in Virginia because the defendants suffered no actionable injury until the plane was sold below the promised price at the public sale in Virginia. *Id.* at 321, 339 S.E.2d at 94. Thus, Virginia law applied to the claim, and the claim failed as Virginia had no similar statutory claim. *Id.* at 321-22, 339

S.E.2d at 94.[9] Likewise, the court found that Virginia law applied to defendants' claim of breach of fiduciary relationship because the last act giving rise to the alleged breach was the sale of the plane, which occurred in Virginia. *Id.*

In *Lloyd* and *United Virginia Bank,* the Court of Appeals looked at the location of the last act, as well as the other acts, and found the injury was sustained at the location of the last act. Other federal courts in North Carolina have followed the last act rule. *Santana v. Levi Strauss and Co.,* 674 F.2d 269, 273 (4th Cir. 1982) (deductions to plaintiff invoices were made by defendant in California and constituted the last act necessary to render defendant liable for fraud and unfair and deceptive trade practices claims); *United Dominion Indus. Inc. v. Overhead Door Corp.*, 762 F. Supp. at 130-31 (citing *United Virginia Bank*, and concluding that where in a claim involving the purchase of a company, the last act which injured the plaintiff, a corporation headquartered in North Carolina, occurred in Texas when the transaction closed, as Texas was the place where defendant conveyed the assets and plaintiff delivered the money); *Jordan v. Shaw Indus. Inc.*, 131 F.3d 134 (4th Cir. 1997) (unpublished, but cited in published and unpublished opinions) (where employees sued their employer for fraud claims based on the employer's promises to employees that they would still have jobs after a merger, the last act necessary was the employees' reasonable reliance on the employer's false representation, and thus, the state in which each employee was located and received the assurances from the employer of continued employment was the state which laws applied to that employee's claim).

The North Carolina Business Court has also followed the last act rule. In *First Union Corp. v. Suntrust Banks, Inc.*, 2001 WL 1885687, 2001 NCBC 7 (N.C. Super. 2001), this Court rejected SunTrust's argument that it suffered injury at its headquarters in Georgia and that Georgia law must apply to its claims. *First Union Corp. v. Suntrust Banks, Inc.*, 2001 WL

[9] The Court of Appeals found the "where the injuries are sustained" test preferable to the "most significant relationship" test, but said the most significant relationship test would have yielded the same result. *Id.* at 322, 339 S.E.2d at 94.

1885687, *2. Instead, this Court found that SunTrust, if it was injured, was injured by virtue of the merger agreement between First Union and Wachovia executed in North Carolina and that the execution of the merger agreement was the last act giving rise to the cause of action. Id. Therefore, Suntrust's claim for breach of fiduciary duty was governed by North Carolina law.[10] Id.

The last event necessary which gave rise to Harco's claims against Grant Thorton occurred in North Carolina. Harco's claims against GT for fraud and negligent misrepresentation are based on its reliance of GT's audits of CBC's financial statements. The last act which gave rise to the claims was Harco's reliance when it agreed to become an issuing carrier. Harco received GT's audit opinions in Pennsylvania, and Harco relied on the audit opinions in North Carolina and Nebraska, where Pirrung, Stephano and Coon thoroughly reviewed the audited financials. Mr. Stephano made the decision to become an issuing carrier for the CBC program from Raleigh based on his review and analysis of the financial statements. Therefore, under the last event necessary analysis, North Carolina law applies to Harco's claims because Harco relied on and acted in reliance on the financial statements in North Carolina.

III. North Carolina Law Applies Under the Second Restatement's Significant Relationship Approach.

The more modern conflict of laws test, the most significant relationship test, is set out in the Restatement (Second) of Conflict of Laws. Pursuant to the Second Restatement, "the rights and liabilities of the parties with respect to an issue in tort are determined by the local law of the state which, with respect to that issue, has the most significant relationship to the occurrence and the parties under the principles stated in § 6." Restatement (Second) of Conflict of Laws § 145. The contacts to be considered include

[10] This Court also found that North Carolina was the state with the most significant relationship to the claims.

> (a) the place where the injury occurred, (b) the place where the conduct causing the injury occurred, (c) the domicil, residence, nationality, place of incorporation and place of business of the parties, and (d) the place where the relationship, if any, between the parties is centered. These contacts are to be evaluated according to their relative importance with respect to the particular issue.

Restatement (Second) of Conflict of Laws § 145(2). The Second Restatement further indicates that for the torts of false representations, whether fraudulent, negligent or innocent, these additional rules apply:

> (1) When the plaintiff has suffered pecuniary harm on account of his reliance on the defendant's false representations and when the plaintiff's action in reliance took place in the state where the false representations were made and received, the local law of this state determines the rights and liabilities of the parties unless, with respect to the particular issue, some other state has a more significant relationship under the principles stated in § 6 to the occurrence and the parties, in which event the local law of the other state will be applied.
>
> (2) When the plaintiff's action in reliance took place in whole or in part in a state other than that where the false representations were made, the forum will consider such of the following contacts, among others, as may be present in the particular case in determining the state which, with respect to the particular issue, has the most significant relationship to the occurrence and the parties:
>
> (a) the place, or places, where the plaintiff acted in reliance upon the defendant's representations,
> (b) the place where the plaintiff received the representations,
> (c) the place where the defendant made the representations,
> (d) the domicil, residence, nationality, place of incorporation and place of business of the parties,
> (e) the place where a tangible thing which is the subject of the transaction between the parties was situated at the time, and
> (f) the place where the plaintiff is to render performance under a contract which he has been induced to enter by the false representations of the defendant.

Restatement (Second) of Conflict of Laws § 148.

While most North Carolina courts have continued to use the *lex loci delecti* test, some North Carolina courts have utilized the most significant relationship test. *See, e.g., Michael v. Greene*, 63 N.C. App. 713, 306 S.E.2d 144 (1983); *Andrew Jackson Sales v. Bi-Lo Sales, Inc.*, 68 N.C. App. 222, 314 S.E.2d 797 (1984). For example, in *Michael v. Greene*, the North Carolina Court of Appeals found that Texas law applied to unfair and deceptive trade practices and fraud

claims involving the sale of wholesale jewelry because Texas had the most significant relationship to the matter. *See, e.g., Michael*, 63 N.C. App. at 715, 306 S.E.2d at 145. The discussions between the parties took place in Texas, the alleged misrepresentations were made in Texas, and the plaintiff placed his first order with defendant while in Texas. *Id.* Further, all the orders were filled in Texas, and the jewelry was delivered from Texas to North Carolina. *Id.*

Additionally, many courts have determined that they would come to the same conclusion using either the significant relationship test or the *lex loci delecti* test. *Santana,* 674 F.2d 269, 273-74; *N.C. Mutual Life. Ins. Co. v. McKinley Fin. Serv. Inc.*, 386 F. Supp. 2d 648, 658 n.4 (M.D.N.C. 2005); *Waldon v. Burris*, 2007 WL 2300793, *2 n.1 (W.D.N.C. Aug. 2007); *First Union Corp. v. Suntrust Banks, Inc.*, 2001 WL 1885687.

Some federal courts interpreting North Carolina law have also used the significant relationship test. In *Lowe's North Wilkesboro Hardware, Inc. v. Fid. Mut. Life Ins. Co.*, 319 F.2d 469 (4th Cir. 1963), the claim was for negligent delay in acting upon an application for a life policy where the proposed insured died before a policy was issued. *Id.* at 470. The plaintiff argued that North Carolina law applied because the deceased's residence in life and place of death was North Carolina and the insurance form was completed in North Carolina. *Id.* at 474. However, the court found that Pennsylvania had the most significant relationship to the claim because the application was sent to Pennsylvania and the alleged delay took place there and that these factors involving Pennsylvania were more significant than the factors concerning North Carolina. *Id.* at 473-74.

Additionally, the Eastern District of North Carolina used the most significant relationship test to apply North Carolina law to claims surrounding a multistate disparagement campaign after considering the following factors: the campaign was directed at a North Carolina corporation; the corporation had its principal place of business in North Carolina; the campaign

was carried out by a multinational corporation which had offices in North Carolina and was doing extensive business in North Carolina; and the campaign included widespread disparagement of plaintiff in North Carolina. *American Rockwool,* 640 F. Supp. at 1434. *See also, Simms Inv. Co. v. E.F. Hutton & Co.*, 688 F. Supp. 193, 198-200 (M.D.N.C. 1988) (holding that North Carolina would apply the significant relationship test in a case involving claims of misrepresentations of forming joint venture, but finding that test of where injury occurred would yield same result).

Under the most significant relationship test, North Carolina is the choice of law as North Carolina or Pennsylvania has the most significant relationship to this matter. Applying the factors noted in Section 145(2) of the Second Restatement, the following facts are significant:

(a) The injury occurred in North Carolina, as discussed *supra*.

(b) The conduct causing the injury occurred in Pennsylvania where GT auditors were located and licensed and where they negligently and fraudulently conducted the CBC audits.

(c) GT is an LLP organized and existing under the laws of the state of Illinois. GT has fifty offices in the United States, including offices in Wake County, North Carolina. GT regularly conducts business in North Carolina and Pennsylvania.

(d) Harco is a corporation organized and existing under the laws of the state of Illinois, with a statutory office in Illinois and executive offices in North Carolina. Harco sells insurance in 49 states.

(e) The relationship between Harco and CBC and GT and CBC is centered in Reading, Pennsylvania. CBC retained GT to perform audits of its financial statements in Pennsylvania. Auditors from GT's Philadelphia office performed the audits of the CBC financial statements in Reading, Pennsylvania. The audit opinions for year-end 2000 and 2001 were issued in

Pennsylvania. Vince Smith distributed the audit opinions to Harco in Reading, Pennsylvania and Raleigh, North Carolina. Harco relied upon the financial statements authored by GT in Raleigh.

If the Court determines that the false representations were made in Pennsylvania but that the act of reliance occurred in North Carolina, the Court may consider factors from Section 148(2) of the Second Restatement to determine which state has the most significant relationship to the occurrence and to the parties. The following facts should then be considered:

(a) Harco acted in reliance on the representations in the financial statements in Raleigh, North Carolina, when it made the decision to become an issuing carrier for the program.

(b) Harco initially received the financial statements in Reading, Pennsylvania, but additional representatives received the financial statements in Raleigh, North Carolina and Omaha, Nebraska.

(c) GT made the misrepresentations in its audit opinions which were issued to CBC in Philadelphia, Pennsylvania.

(d) GT is an LLP organized and existing under the laws of the state of Illinois. GT has fifty offices in the United States, including offices in Wake County, North Carolina. GT regularly conducts business in North Carolina and Pennsylvania. Harco is a corporation organized and existing under the laws of the state of Illinois. Harco sells insurance in 49 states. Harco's executive office is located in Raleigh, North Carolina.

(e) Harco primarily rendered performance under the PAA by monitoring the program from Raleigh. Mr. Coon oversaw the program from Omaha. The decisions related to the program were made in Raleigh and Omaha. To a lesser extent, Harco also rendered performance under the PAA in Illinois where agents were licensed and premium payments were received.

Considering all of the Second Restatement's various factors, North Carolina or Pennsylvania has the most significant relationship to this matter.

Conclusion

The last act giving rise to Harco's claim against Grant Thornton occurred in North Carolina. It is also where Harco sustained injury. Finally, North Carolina has the most significant relationship to the events giving rise to Harco's claim. Wherefore, Harco National Insurance Company respectfully requests that this Court grant Harco's amended choice of law motion and determine that North Carolina's laws are applicable to the claims in this matter.

This 5th day of December 2008.

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CERTIFICATE OF COMPLIANCE

This brief complies with Rule 15.8 of the General Rules of Practice and Procedure for the North Carolina Business Court as reported by the word-processing software.

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing **Harco National Insurance Company's Amended Brief In Support Of Its Motion For A Choice of Law Determination** was served on all counsel of record addressed as follows via electronic service.

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