No. 10-693

In the Supreme Court of the United States

ERNST & YOUNG LLP, et al.,

Petitioners,

v.

SHARON P. CLARK,

Commissioner for the Kentucky Department Of Insurance and Rehabilitator of AIK Comp, et al.,

Respondents.

On Petition For A Writ of Certiorari to the Supreme Court of Kentucky

BRIEF OF THE CENTER FOR AUDIT QUALITY AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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BRIEF OF THE CENTER FOR AUDIT QUALITY AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

INTEREST OF THE *AMICUS CURIAE*[1]

The Center for Audit Quality ("CAQ") is a public policy organization that seeks to aid investors and the capital markets by advancing constructive suggestions rooted in the audit and accounting profession's core values of integrity, objectivity, honesty, and trust. Any U.S. accounting firm registered with the Public Company Accounting Oversight Board ("PCAOB") may join the CAQ. The CAQ is affiliated with the American Institute of Certified Public Accountants, and has approximately 750 U.S. public company accounting firms as members, representing tens of thousands of professionals dedicated to audit quality.

The CAQ seeks to improve the reliability of public company audits and to enhance their relevance for investors, particularly in this time of growing financial complexity and globalization. The CAQ is dedicated to helping increase public confidence in the auditing process and to maintaining high standards in the accounting profession. To fulfill its mission, the

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[1] No counsel for a party wrote this brief in whole or in part, and no counsel for a party or party made a monetary contribution intended to fund the preparation or submission of this brief. No person or entity other than *amicus curiae*, its members, or its counsel made a monetary contribution to this brief's preparation or submission. Petitioners and respondents have consented to the filing of this brief; their written consents have been submitted to the Clerk.

CAQ offers recommendations to policymakers, issues technical support for public company auditing professionals, and participates in the public discussion about financial reporting. For example, among many other recent activities, the CAQ has filed *amicus* briefs in cases concerning the unconstitutionality of statutory provisions for removal of members of the PCAOB; the confidentiality of documents, communications, and information regarding or relating to a PCAOB inspection; and the distinction between primary and secondary liability under Section 10(b) of the Securities Exchange Act of 1934.

The CAQ has a keen interest in legal rules that affect auditors and the audit process, and the broader impact of such rules on investors and capital markets. Enforcement of agreements between auditors and their clients to resolve their disputes through arbitration, rather than litigation, is a matter of surpassing importance to the audit profession and clients. In the Federal Arbitration Act, Congress instructed courts to treat arbitration agreements as "valid" and "enforceable" absent traditional legal or equitable grounds for the judicial revocation of a particular arbitration agreement. 9 U.S.C. § 2. Acting in reliance on that protection, auditors and their clients routinely agree that disputes arising from an audit engagement will be arbitrated rather than litigated. These agreements, freely negotiated between sophisticated commercial enterprises, serve important interests. In this context, as in many others, arbitration is often preferred because it will avoid the cost and delay associated with litigation, and because the parties value the experience and expertise that arbitrators bring to the dispute resolution process. By agreeing to arbitrate, the parties can assure that their disputes will be resolved by arbitrators who understand complex business transactions, the client's industry, and the accounting and auditing principles that are often implicated in these disputes. Both auditors and their clients realize substantial benefits from arbitration.

In this case, the Supreme Court of Kentucky refused to enforce an arbitration agreement between an audit firm (petitioner Ernst & Young LLP) and its client (AIK Comp). That refusal was not based on any "grounds as exist at law or in equity for the revocation" of the agreement, which, if such grounds existed, would have been consistent with the FAA. See 9 U.S.C. § 2. Rather, the refusal was based on the mistaken conclusion that the FAA was not applicable at all, because it was "reverse preempted" by state law. That conclusion, in turn, rested on a misreading of another federal statute, the McCarran-Ferguson Act, which provides that federal law, unless it "specifically relates to the business of insurance," may not be construed to "invalidate, impair, or supersede" state laws enacted "for the purpose of regulating the business of insurance." 15 U.S.C. § 1012(b).

In reaching this incorrect result, the Supreme Court of Kentucky disregarded this Court's decision in *Dep't of Treasury* v. *Fabe*, 508 U.S. 491 (1993). As the petition explains (Pet. 16-18), *Fabe* requires an inquiry whether the *specific* state statutory provision that supposedly would be "impair[ed]" by the federal statute was enacted to regulate "the business of insurance." "Reverse preemption" under the McCarran-Ferguson Act is not justified merely because that specific state statutory provision is, in the words of the opinion below, "a part" of a broader statutory scheme that regulates the business of insurance. Pet. App. 11. Even worse, the Supreme Court of Kentucky failed to honor the distinction that this Court consistently has drawn between "the business of insurance" (which the McCarran-Ferguson Act addresses) and "the business of insurance companies" (which it does not address), and prevented an arbitration that would not "invalidate, impair, or supersede" – indeed, would not alter in any meaningful way – the "substantive rights" of either party to the dispute. See Pet. 23-25. The decision expands the application of reverse preemption well beyond the limits established by this Court, and deepens an existing circuit split between *AmSouth Bank* v. *Dale*, 386 F.3d 763 (6th Cir. 2004), and *Davister Corp*. v. *United Republic Life Ins. Co.*, 152 F.3d 1277 (10th Cir. 1998). See Pet. 26-33.

The CAQ respectfully submits this *amicus curiae* brief to underscore that the holding below has ramifications far beyond the particular dispute involved in this case. If the McCarran-Ferguson Act is improperly construed, as in the decision below, it could abrogate existing arbitration agreements and adversely affect the terms of future agreements between auditors and insurance company clients. The CAQ urges this Court to grant the petition and to correct the erroneous decision below.

SUMMARY OF ARGUMENT

I. By reviewing, auditing, and opining on the financial statements of America's businesses, audit firms provide an essential national service. For that reason, one of the CAQ's top priorities is to foster legal regimes that appropriately resolve claims against auditors in a timely and efficient manner. There are formidable obstacles to achieving that goal. Audit-related disputes typically involve complex factual and legal issues: whether there were material misstatements or omissions in the company's financial statements; if so, whether the auditor should have detected those problems; and if so, whether and to what degree did that failure cause the plaintiff compensable injury. Litigating such complex issues can be extraordinarily costly, and arbitration can substantially reduce those costs. By agreeing to arbitrate their disputes, parties can also ensure that their disputes will be resolved by decisionmakers whose expertise and experience will enhance the dispute resolution process. Because of their expertise, skilled arbitrators are well positioned to identify outcome-determinative issues and to efficiently structure discovery and the hearing process to focus on those issues. Arbitrators are also less likely than lay jurors to misunderstand the role of auditors and the meaning of their opinions, and less likely to render disproportionate judgments. And arbitration may be especially attractive if a party has reasonable concerns of parochialism by state courts and local jurors. Arbitration is not a perfect solution, and some parties may prefer to litigate their disputes, rather than arbitrate. Existing law protects their rights to choose to do so when they enter into contracts. But the FAA also protects the rights of parties to choose to arbitrate their disputes, and requires courts to enforce agreements to do so. The decision below would change settled law and sharply limit the arbitration alternative.

II. As misconstrued by the Supreme Court of Kentucky, the McCarran-Ferguson Act could deprive any party that provides goods or services to an insurance company of its contractual right to arbitrate. For auditors and their clients, those arbitration rights are especially important. Auditors face a large number of claims that allege very large amounts of damages, and incur very large costs litigating such claims. The potential cost savings from arbitrating rather than litigating are therefore very large. Given the number and magnitude of claims, auditors and their clients also have compelling reasons to reduce the risk that the resolution of any claim may be swayed by factors other than the merits of the claim – in particular, to reduce the risk that common public misconceptions about auditing may improperly influence a jury's verdict. If auditors are unable to enforce arbitration agreements with insurance companies, the enhanced cost and risk of litigating rather than arbitrating disputes will predictably be passed on to insurance company clients, with a corresponding rise in premium costs.

Misinterpretation of the McCarran-Ferguson Act could strip away arbitration rights in a very large sector of the economy. Insurance is a $1.7 trillion industry, served by nearly 8000 insurers, and a refusal to enforce arbitration agreements with insurance companies in rehabilitation would deny arbitration rights in the exact circumstance in which those rights are most valuable – when claims are brought before state court judges and juries by state insurance officials or receivers seeking to maximize recoveries in the wake of the failure of a local insurance company, and auditors face the greatest risk of being treated as a deep pocket reinsurer. The decision below therefore threatens real and serious harm to the auditing profession and the businesses, investors, and markets that depend on that profession. The petition should be granted.

ARGUMENT

Section 2 of the Federal Arbitration Act provides that arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. "[T]he basic purpose of the Federal Arbitration Act is to overcome courts' refusals to enforce agreements to arbitrate." *Allied-Bruce Terminix Companies* v. *Dobson*, 513 U.S. 265, 270 (1995) (citing *Volt Information Sciences, Inc*. v. *Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 474 (1989)). The FAA "preempts state law; and * * * state courts cannot apply state statutes that invalidate arbitration agreements." *Dobson*, 513 U.S. at 272 (citing *Southland Corp.* v. *Keating*, 465 U.S. 1, 15-16 (1984)). In this case, the Supreme Court of Kentucky did what *Dobson* and *Southland* said state courts cannot do. It held that a Kentucky statute's "broad grant of exclusive jurisdiction to the Franklin Circuit Court in matters relating to the delinquency of insurance companies preempts and supersedes the Federal Arbitration Act and its policy favoring arbitration." Pet. App. 9-10.

That holding arose from a misinterpretation of the McCarran-Ferguson Act, which provides that federal law, unless it "specifically relates to the business of insurance," may not be construed to "invalidate, impair, or supersede" state laws enacted "for the purpose of regulating the business of insurance." 15 U.S.C. § 1012(b). This Court, however, has emphasized that the McCarran-Ferguson Act addresses "the 'business of insurance' and not the 'business of insurance companies.'" *Group Life & Health Ins. Co.* v. *Royal Drug Co.*, 440 U.S. 205, 217 (1979). The "business of insurance" typically involves "transferring or spreading a policyholder's risk" to the insurer, the policy relationship between the insurer and the insured, and practices that are limited to the insurance industry. *Union Labor Life Ins. Co.* v. *Pireno*, 458 U.S. 119, 129 (1982); *Fabe*, 508 U.S. at 505. For that reason, an insurance company's "arrangements for the purchase of goods and services" – undoubtedly part of the business of an insurance *company* – are not the "business of insurance." *Royal Drug*, 440 U.S. at 214.

In this case, the plaintiff has asserted an ordinary tort claim arising from an insurance company's contract to purchase auditing and accounting services. That claim has nothing to do with transferring or spreading risk or the policy relationship between the insurer and the insured. The same is true for the question whether to resolve that claim through arbitration or litigation. The underlying claim of auditor negligence, and whether to arbitrate or litigate that claim, are not unique to the insurance industry; those issues may arise in any industry.

The decision below therefore does not meaningfully advance the state's interest in regulating the business of insurance. It does, however, threaten serious harm to the federal policy of protecting consenting parties' rights to secure the benefits of resolving commercial disputes through arbitration, rather than litigation. Countless businesses have entered into contracts in reliance on the right to arbitrate, rather than litigate, disputes arising under the contract. As we explain below, contracts between auditors and their clients routinely include arbitration provisions, and do so because arbitration provides compelling benefits to both parties. A decision that jettisons those arbitration rights threatens to upset those settled expectations, and to cause serious harm to the broader public interest in promoting effective auditing services.

I. CONTRACTING PARTIES AGREE TO ARBITRATE IN ORDER TO OBTAIN TIMELY AND EFFICIENT RESOLUTION OF THEIR DISPUTES BY EXPERT ADJUDICATORS

Auditors provide services that are essential to businesses, their investors and creditors, and the national economy. "Ultimately, it is a combination of transparency and trust that enables our financial markets to function efficiently. A strong and vibrant auditing profession is a critical element of that regime and especially important to the U.S. capital markets where more than 100 million people invest their savings and retirement assets." Department Of The Treasury, Advisory Committee On The Auditing Profession, FINAL REPORT II:1 (Oct. 6, 2008) (hereafter cited as "*Advisory Committee Report*"); see also Commission On The Regulation Of U.S. Capital Markets In The 21st Century, REPORT AND RECOMMENDATIONS 8 (Mar. 2007) (hereafter cited as "*Commission Report & Recommendations*") ("The independent auditing firms play a critical role in our capital markets by providing reasonable assurance on the financial statements of public companies. Thus, the Commission believes that sustaining a strong, economically viable public company audit profession is vital to domestic and global capital markets.").

Because of the importance of audit services, one of the principal objectives of the CAQ is to promote a legal regime that effectively and fairly resolves legal claims against auditors. Such a regime should resolve allegations of inadequate performance by auditors in a timely, efficient, and predictable manner. It should minimize both false negatives (erroneous decisions that permit auditors to escape liability when their performance has been deficient under applicable professional standards and has caused compensable injury) and false positives (erroneous decisions that hold auditors liable when they have done nothing wrong or, if the auditor is liable, that award damages that are excessive under the applicable legal standards). As we explain below, arbitration is often far superior to litigation in state and federal courts in achieving those objectives.

Achieving these objectives is no easy task. Claims of inadequate auditor performance require a judgment whether a business's financial statements were materially misleading. That judgment often requires a complex factual inquiry (to understand the underlying business transactions, their economic rationale, and their anticipated and actual financial results) *and* a sophisticated understanding and application of the relevant accounting and auditing principles (which require the exercise of professional judgment). But even if there is a determination that a business's financial statements were materially misleading, that determination is merely the *beginning* of the inquiry. There remains the question whether the auditor failed to comply with the relevant professional standards when opining on those financial statements. This determination, too, will likely involve complex factual issues and difficult questions about the proper exercise of professional judgment. Finally, even if the auditor's opinion was actionable, assessing loss causation and measuring damages add more difficulty, because it is often unclear whether, or to what extent, a plaintiff's financial losses are attributable to materially misleading financial statements and an auditor's opinion thereon, rather than the business's performance or other factors.

Auditors and their clients, alike, recognize that in resolving such questions, arbitration has many advantages. For that reason, agreements between auditors and their clients often provide that disputes will be subject to arbitration, rather than litigation.

Arbitration can generally resolve disputes more efficiently and at lower cost than can litigation. Even routine litigation is often slow moving and, with protracted discovery, can be hugely expensive. But claims against auditors are by no means routine litigation. Such claims, when litigated, entail complex legal and factual issues, enormous discovery costs, and the intensive involvement of experts.

Arbitration can substantially reduce these costs by limiting discovery and streamlining procedures. For example, while federal discovery rules are famously "liberal," *Swierkiewicz* v. *Sorema N. A.*, 534 U.S. 506, 512 (2002), the American Arbitration Association's rules governing arbitration in accounting disputes permit the arbitrator, "[c]onsistent with the expedited nature of arbitration," to set the parameters of discovery, including whether to permit discovery at all. AAA, Professional Accounting and Related Services Dispute Resolution Rules, Rule 10, (http://www.adr.org/sp.asp?id=22012).

This Court has consistently recognized the superior efficiency and lower expense that arbitration typically offers over litigation. Just last Term the Court acknowledged that "[i]n bilateral arbitration, parties forgo the procedural rigor and appellate review of the courts in order to realize the benefits of private dispute resolution: lower costs, greater efficiency and speed, and the ability to choose expert adjudicators to resolve specialized disputes." *Stolt-Nielsen S.A.* v. *Animalfeeds Int'l Corp.*, 130 S. Ct. 1758, 1775 (2010). Thus, a "prime objective of an agreement to arbitrate is to achieve 'streamlined proceedings and expeditious results.'" *Preston* v. *Ferrer*, 552 U.S. 346, 357-58 (2008) (quoting *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 633 (1985)); see also *Gilmer* v. *Interstate/Johnson Lane Corp.*, 500 U.S. 20, 31 (1991) (same).

By agreeing to arbitrate their disputes, auditors and their clients can also ensure that such disputes will be heard by decisionmakers with expertise and experience that will enhance the quality of the dispute resolution process. As many courts – this Court first among them – have recognized, access to expert adjudicators provides a compelling reason to choose arbitration:

> "[A]daptability and access to expertise are hallmarks of arbitration. The anticipated subject matter of the dispute may be taken into account when the arbitrators are appointed, and arbitral rules typically provide for the participation of experts either employed by the parties or appointed by the tribunal.

Mitsubishi Motors, 473 U.S. at 633; see also, *e.g.*, *Alexander* v. *Gardner-Denver Co.*, 415 U.S. 36, 57 (1974) ("Parties usually choose an arbitrator because they trust his knowledge and judgment concerning the demands and norms of industrial relations."); *Stolt-Nielsen*, 130 S. Ct. at 1775 ("benefits of private dispute resolution" include "the ability to choose expert adjudicators to resolve specialized disputes); *Uhl* v. *Komatsu Forklift Co.*, 512 F.3d 294, 308 (6th Cir. 2008) ("Arbitrators are often chosen for their expertise and community involvement * * * *"); *Positive Software Solutions, Inc.* v. *New Century Mortg. Corp.*, 476 F.3d 278, 285-86 (5th Cir. 2007) (en banc) ("expertise" and the "benefit of specialized knowledge" are among arbitration's "most attractive features apart from speed and finality"); *Lucent Techs., Inc.* v. *Tatung Co.*, 379 F.3d 24, 28 (2d Cir. 2004) ("[A] principal attraction of arbitration is the expertise of those who decide the controversy * * * *") (quotation marks omitted); *Lefkovitz* v. *Wagner*, 395 F.3d 773, 780 (7th Cir. 2005) (Posner, J.) (same); *ANR Coal Co.* v. *Cogentrix of N.C., Inc.*, 173 F.3d 493, 500 (4th Cir. 1999) (same); *Rosenberg* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 170 F.3d 1, 7 n.4 (1st Cir. 1999) (same); *Bowles Fin. Group, Inc.* v. *Stifel, Nicolaus & Co.*, 22 F.3d 1010, 1013 (10th Cir. 1994) (same); *Marino* v. *Writers Guild of Am., East, Inc.*, 992 F.2d 1480, 1483 (9th Cir. 1993) (same); see also, *e.g.*, AAA, Professional Accounting and Related Services Dispute Resolution Rules, Rule 4, (http://www.adr.org /sp.asp?id=22012) (establishing a "National Panel of Accounting and Related Services Arbitrators" based on eligibility requirements set in consultation with the National Accounting Industry Dispute Resolution Committee).

The expertise that arbitrators bring to the dispute resolution process is valuable for many reasons. That expertise is an important factor in achieving timely and efficient disposition of claims. Arbitrators may have greater knowledge of the governing legal principles at the *outset* of the dispute resolution process than non-expert adjudicators would have at the *conclusion* of the process. For that reason, skilled arbitrators may be better positioned than judges to identify the issues that will be outcome determinative and to efficiently structure discovery and the hearing process to focus on those issues.

The expertise of arbitrators also reduces the risk that the ultimate resolution of the dispute will be swayed by a misunderstanding of the role and responsibilities of auditors and the meaning of audit opinions. The general public – and, unfortunately, many lay jurors and some courts – often have fundamental misunderstandings about those matters. A common misconception is that in all cases there is a single, "right" way to present a company's financial performance and that the "right" presentation is a function of objective facts that can be readily confirmed. Starting with those false premises, many believe that a clean audit opinion is tantamount to the auditor's guarantee that the company's financial statements reflect the only permissible presentation of the company's financial performance and are completely accurate in every detail. If a company's financial statements are later found to be materially misleading, the thinking goes, the auditor must have been derelict for not discovering and reporting the truth. Such beliefs, though widely held, are simply wrong.

An auditor's opinion "is not a simple statement of verifiable fact that * * * can be easily checked against uniform standards of indisputable accuracy." *Bily* v. *Arthur Young & Co.*, 3 Cal. 4th 370, 400 (Cal. 1992). Rather, it is a "professional opinion" that is the "final product of a complex process involving discretion and judgment on the part of the auditor at every stage" because the opinion is "based on the auditor's interpretation and application of hundreds of professional standards, many of which are broadly phrased and readily subject to different constructions." *Ibid.*

What is more, the auditor must rely on information supplied by the client. "For practical reasons of time and cost, an audit rarely, if ever, examines every accounting transaction in the records of a business" and auditors' decisions about which sample of records to examine, and whether and how to verify the accuracy of the records, are themselves decisions that "require a high degree of professional skill and judgment." *Id.* at 380. As the Third Circuit has explained, an audit "does not guarantee that a client's accounts and financial statements are correct any more than a sanguine medical diagnosis guarantees well-being; indeed, even an audit conducted in strict accordance with professional standards countenances some degree of calibration for tolerable error which, on occasion, may result in a failure to detect a material omission or misstatement." *In re IKON Office Solutions, Inc.*, 277 F.3d 658, 673 (3d Cir. 2002).

Because arbitrators are less likely to harbor such misconceptions, their expertise in the relevant subject matter naturally leads to better decision making. As this Court put it, "[A]lign[ing] (1) decisionmaker with (2) comparative expertise will help better to secure a fair and expeditious resolution of the underlying controversy – a goal of arbitration systems and judicial systems alike." *Howsam* v. *Dean Witter Reynolds, Inc.*, 537 U.S. 79, 85 (2002); see also, *e.g.*, *Lefkovitz*, 395 F.3d at 780 ("Parties that opt for arbitration trade the formalities of the judicial process for the expertise and expedition associated with arbitration, a less formal process of dispute resolution by an umpire who is neither a generalist judge nor a juror but instead brings to the assignment knowledge of the commercial setting in which the dispute arose."); *ANR Coal Co.*, 173 F.3d at 500 ("Parties value commercial arbitration, at least in part, because they prefer a tribunal knowledgeable about the subject matter of their dispute to a generalist court with its austere impartiality but limited knowledge of subject matter." (internal quotation marks omitted)).

Arbitration has another important advantage in cases, such as this one, in which a party may have reasonable concerns of state parochialism. In this case, the claim involves an in-state insurer and was brought by a state official (the rehabilitator) demanding a trial by a state court jury with an elected judge. See Ky. Const. § 117. Such cases present the risk that the jury's or judge's natural sympathies may lie with the local "victim" rather than the distant and faceless audit firm. As this Court has already recognized (in the punitive damage context), juries may "use their verdicts to express biases against big businesses, particularly those without strong local presences." *State Farm Mut. Auto. Ins. Co.* v. *Campbell*, 538 U.S. 408, 417 (2003) (quotation marks omitted). Local juries may be acutely conscious of the impact of a business failure within their own community; state court judges may lack experience or training related to the kinds of issues that may be determinative of claims against auditors; and, where a local business has failed, its auditor may be perceived as a deep-pocketed defendant that is the only solvent entity from which plaintiffs may seek to recover their losses. For these reasons, too, parties may reasonably believe that submission of audit disputes to expert arbitrators will reduce the risk that the dispute will be resolved on any basis other than its merits.

Reflecting the many advantages of arbitration, parties to commercial arbitration are generally very satisfied with its results and prefer it to litigation – which is reflected in the high incidence of agreements to arbitrate within commercial sectors, including the accounting and auditing industries. See generally David B. Lipsky & Ronald L. Seeber, THE APPROPRIATE RESOLUTION OF CORPORATE DISPUTES: A REPORT ON THE GROWING USE OF ADR BY U.S. CORPORATIONS (1998). To be sure, no legal regime can achieve perfection, and arbitration, like litigation, has both advantages and disadvantages. After weighing the alternatives, some parties may prefer to litigate their disputes, rather than submit them to arbitration. Existing law protects the rights of parties to choose that option (explicitly or by default) when they enter into contracts. But existing law also protects their rights to choose to resolve future disputes through arbitration. When both parties agree that arbitration should be used – because they value the expedition and efficiency of arbitration, the expertise of arbitrators, or for any other reason – the FAA requires courts to honor and enforce that choice. Unfortunately, the decision below, if uncorrected, would change settled law and sharply limit the arbitration alternative.

II. THE BENEFITS OF ARBITRATION ARE ESPECIALLY IMPORTANT TO AUDITORS AND THEIR CLIENTS

The decision below seriously undermines the federal interest in protecting consenting parties' right to arbitrate their disputes. Because of the widely-recognized advantages of arbitration, a large proportion of commercial agreements contain arbitration provisions. As misconstrued by the Supreme Court of Kentucky, the McCarran-Ferguson Act could deprive *any* party that provides goods or services to an insurance company of its contractual right to arbitrate, and for that reason, the consequences of such a misinterpretation are far reaching.

For auditors, their clients, and their clients' investors and creditors, the limitation on arbitration rights is particularly significant. Because claims against auditors involve complex issues that can be extraordinarily costly to litigate, the time and cost savings of arbitration can be very large. A recent study indicated that the six largest auditing firms, on average, incurred litigation and practice protection costs that were greater than 15% of their audit-related revenues. *Advisory Committee Report* at VII:25. Parties to such disputes bear these costs directly, in addition to the numerous indirect expenses they incur through the distraction of litigation and resulting lost productivity.

The ability to ensure that claims are resolved by expert decisionmakers is also a substantial benefit for auditors and their clients. In 2006, the nation's largest association of businesses – an organization that represents the interests of audit *clients* – issued a report that described auditing as "a profession at risk," in large part because of "litigation risk" related to "misunderstandings about the meaning and nature of accrual accounting systems and the level of precision inherent in such systems." U.S. Chamber of Commerce, AUDITING: A PROFESSION AT RISK 5 (Jan. 2006) (http://www.uschamber.com/sites/default/files/reports/0601auditing.pdf). The report emphasized the importance of arbitration and other forms of alternative dispute resolution for claims against auditors, cautioning that "[i]t is simply not reasonable to expect juries and nonexpert judges to properly evaluate arcane accounting judgments and auditing methodologies." *Id.* at 11; see also *Commission Report & Recommendations* at 109 ("[M]uch of the confidence of the entire market now rests on just four [audit firms], and * * * litigation risk is a substantial impediment toward expanding the number of audit firms willing to audit large public companies.").

Moreover, given the magnitude of many of the claims at issue, auditors and clients have compelling reasons to seek to reduce the risk that a dispute will be resolved on any basis other than its merits. Auditors are reasonably concerned that complaints against them, even if they lack merit, may receive a sympathetic hearing from those who harbor misconceptions about the role of auditors and the meaning of their opinions. Many of the plaintiffs asserting such claims have suffered very large losses, perhaps (but not necessarily) through no fault of their own. By the time those losses have occurred, the company that actually issued the materially misleading financial statements may be insolvent, and the audit firm is often the only defendant from which the plaintiff can hope to recover its losses. The risk of a catastrophic liability finding by an unsophisticated judge or jury that wants to compensate innocent victims for their losses is very real, and cannot be entirely mitigated by the hope that such errors eventually will be corrected. See, *e.g.*, *BDO Seidman, LLP* v. *Banco Espirito Santo Int'l*, 38 So. 3d 874, 882 (Fla. Dist. Ct. App. 2010) (reversing $500 million judgment against BDO Seidman, LLP and observing that erroneous judgment "would plainly lead to [the defendant's] financial demise" (internal quotation marks omitted)).

The decision below threatens real and serious harm to the auditing profession *and* to auditors' clients. Indeed, by definition, a refusal to enforce an arbitration agreement arises only in circumstances in which both parties to a contract have previously decided that inclusion of an arbitration provision is *mutually* beneficial. If auditors are unable to enforce arbitration agreements with insurance companies and, instead, are forced to resolve disputes through costly and time-consuming litigation, they will predictably charge higher fees when providing their services to insurance company clients or, in some cases, decline to serve such clients at all. As this Court has repeatedly observed, the costs and risks of litigation incurred by auditors and other professionals are ultimately passed on to their customers. See, *e.g.*, *Central Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 189 (1994) ("[E]xcessive litigation can have ripple effects. For example, newer and smaller companies may find it difficult to obtain advice * * * *[and] the increased costs incurred by professionals because of the litigation and settlement costs * * * may be passed on to their client companies."); *Stoneridge Investment Partners, LLC* v. *Scientific-Atlanta, Inc.*, 552 U.S. 148, 164 (2008) ("[C]ontracting parties might find it necessary to protect against these threats [of liability based on weak claims], raising the costs of doing business."). Empirical research has confirmed that observation. See, *e.g.*, Jamie Pratt & James Stice, *The Effect of Client Characteristics on Auditor Litigation Risk Judgments, Required Audit Evidence, and Recommended Fees*, 69 ACCT. REV. 639, 655 (1994); Frederick L. Jones & K. Raghunandan, *Client Risk and Recent Changes in the Market for Audit Services*, 17 J. ACCT. & PUB. POL'Y 169, 179 (1998).

Auditors can take scant comfort in the knowledge that the decision below, if uncorrected, would strip away their right to arbitrate "only" in disputes with insurance companies. Insurance is a $1.7 *trillion* industry in the United States, served by nearly 8000 insurers. See Nat'l Ass'n of Ins. Commissioners, *Overview of United States Insurance Market* (http://www.naic.org/state_report_cards/report_card_us.pdf). Nor is it any consolation that the decision would (at best) eliminate arbitration rights involving *financially troubled* insurance companies. The costs and risks of insurer claims against auditors (and the benefits of having those claims resolved expeditiously and efficiently, by a decision maker who truly understands the issues) are concentrated precisely in those insurance companies that have experienced financial difficulties, which the auditor may be unfairly expected to recompense.

The decision below does not just misconstrue the McCarran-Ferguson Act and conflict with prior decisions by this Court and others. It threatens real and serious harm to the auditing profession and the businesses, investors, and markets that depend on that profession.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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