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### **THE STRENGTH OF ARBITRATION CLAUSES IN ENGAGEMENT LETTERS**

By Attorney John Hughes,

In *Sasaki v. McKinnon*, an Ohio Appellate Court found that an arbitration clause in an accountant's engagement letter required arbitration of a shareholder's derivative action. This case illustrates how strong a loss control tool engagement letters generally, and arbitration clauses in particular, can be.

The facts of the case were these. The plaintiffs were shareholders of ABS Industries, Inc. They brought a shareholders' derivative action on their own behalf and on behalf of ABS against Ernst & Young which had been retained by ABS to serve as its outside auditor. In their complaint, the plaintiffs maintained that they sustained financial loss when Ernst & Young failed to detect and disclose accounting irregularities and resulting material overstatements in the financial statements of ABS. Based on these alleged deficiencies, plaintiffs asserted claims for breach of contract, malpractice, negligent representation, and contribution and indemnity.

After the suit was brought, Ernst & Young moved to stay the litigation pending arbitration pursuant to a provision in its engagement letter with ABS. In ruling on whether this request for arbitration should be granted, the court held that under Ohio law an arbitration clause in a written contract for settling disputes under the contract was valid, irrevocable and enforceable. In light of this statutory direction, the court ruled that there were no reasons to exempt shareholders' derivative actions from this requirement.

The court stated furthermore that in matters of complex litigation involving securities and investments, arbitrators acquainted with issues common to that industry were better suited to review the claims than a trial court or a jury drawn from the general population. This was because the Court and jury probably would be untrained in the intricacies of the financial markets, sophisticated corporate accounting and the governing regulations. Accordingly, the appellate court confirmed that the trial court's ruling that the shareholders' derivative suit be stayed while the arbitration process was conducted.

Engagement letters can dramatically reduce the costs of defending an accounting malpractice case. This case underscores the importance of including an arbitration provision in engagement letters. Almost every state has a statute encouraging arbitration like the Ohio statute in this case. If these statutes are strong enough to deflect a shareholders' derivative suit, they certainly can be used effectively to stay more mundane claims until those claims are successfully resolved by sophisticated and knowledgeable arbitrators.

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### Areas of Practice

Litigation  
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### Education

Suffolk University Law School, J.D.  
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### Memberships

American Bar Association  
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John practices business litigation and has extensive trial and appellate experience in courts throughout the country. He assists liability insurers with complex claims and coverage matters. He also represents insurers in coverage and bad faith litigation in state and federal courts. Many of his engagements have concerned financial institutions, particularly banks, investment advisers, mutual funds, venture capital funds, and insurance and securities brokers. These cases have involved claims under ERISA, the Investment Company and Investment Advisers Acts of 1940, federal and state securities laws and state law on negligence and breach of fiduciary duty.

John also represents clients involved in accounting malpractice litigation concerning both auditing and tax preparation services. He speaks frequently on the subject of accounting malpractice before both legal and accounting professional groups. He has been quoted on the subject of accounting liability in *The Wall Street Journal*. Through recognition of his knowledge in the area, John has been retained by two major regional accounting firms to advise them on risk management issues. His involvement in these cases (which has been instrumental in creating new legislation) has been noted in professional journals. He has also written numerous articles on accountant liability, which have appeared in a variety of national journals.