

Bank's Auditor, Ernst & Young, Ordered to Pay \$17.2 Million for Accounting Malpractice

For over a decade, Ernst & Young was the independent auditor of Superior Bank, a federal savings bank operating throughout the continental United States. In each of those years, through 2000, E&Y issued to Superior Bank a "clean" or "unqualified" audit opinion – essentially a clean bill of financial health. The audited financial statements showed Superior Bank to be the most profitable private bank in the United States.

In reliance upon the audited financial statements, Alan Schein and Results Technologies, Inc., a corporation based in Dania, Florida, entered into a business relationship with Superior Bank. Schein and Results Technologies had created the Results Mortgage System, a revolutionary way to market high-quality mortgage loans over the telephone, using state-of-the-art interactive computer scripts and systems.

Through agreements executed in 1996 and 1998, Results Technologies' mortgage marketing business became a separate division of Superior Bank, the Universal Lending Division, with Schein as its president. Schein and Results Technologies retained an option to "unwind" and to operate or sell the business as a stand-alone entity with the right to half the profits. Rather than exercise their option before the business had established a track record of maximum profitability, Schein and Results Technologies chose to remain with Superior Bank, in direct reliance upon the financial statements audited by E&Y, which portrayed Superior Bank as a rock-solid financial institution.

After six years of litigation, and a three-week jury trial, Alan Schein and Results Technologies were vindicated. Jurors in the Complex Litigation Division in Broward County found Ernst & Young negligent in their erroneous certification of the bank's financial health. They awarded Schein and Results \$10.2 million in actual damages. Pre-judgment interest brought the final judgment to \$17,263,709.

In early 2000, federal regulators from the Office of Thrift Supervision and the Federal Deposit Insurance Corporation began to question key accounting issues in the financial statements. Rather than admit its mistakes, E&Y dug in its heels, telling Superior Bank that it was right and the federal regulators were wrong.

After debating the matter for a year, and on the eve of a key "showdown" meeting with the regulators, E&Y reversed itself on key accounting issues, admitting that it had been wrong all along in its valuation methodology. E&Y quickly

After years of producing audits for Superior Bank that showed a clean bill of financial health, Ernst & Young finally admitted it erred in evaluating the bank's assets. The most profitable private bank in America was immediately rated insolvent and eventually closed. The bank's investors, having relied on the improper audits, suffered substantial losses for which Ernst & Young was found responsible.

determined that applying the proper accounting to Superior Bank's assets reduced its value by \$420 million, which immediately changed Superior Bank from the most profitable private bank in America to an insolvent bank. Within months, the FDIC formally closed the bank.

Unfortunately, Schein and Results Technologies were trapped in the sinking ship that Superior Bank had become. Had they known that E&Y's accounting work was flawed, they could have unwound their business and sold it for millions of dollars. But when E&Y suddenly and belatedly admitted its mistake, the federal regulators assumed control of Superior Bank and all of the assets in which it held an interest – including the Universal Lending Division.

Schein and Results Technologies retained SDSBS attorneys **Jack Scarola** and **Patrick Quinlan**, and co-counsel Robert Mayer, to recover losses they sustained as a result of E&Y's utter failure as accountants for Superior Bank. While E&Y had admitted its mistake in a private meeting with regulators, it took the position in the lawsuit that it had done nothing wrong. Instead, E&Y blamed bank personnel, the regulators, and even Schein and Results Technologies for any financial problems at Superior Bank. E&Y also contended that the Results Mortgage System had no monetary value. Consistent with this "scorched earth" defense mentality, E&Y made no reasonable offer to settle.

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"The E&Y legal team included as many as eight lawyers in the courtroom at one time," said Alan Schein. "We took everything they could possibly throw at us and still came out on top." ■