

PwC Faces Rare Crisis-Era Suit

BY MICHAEL RAPOPORT

Banks, housing agencies, bond raters and many others have faced legal action over the 2008 financial crisis. Now, an accounting giant is taking its turn.

PricewaterhouseCoopers LLP faces a trial starting Monday over civil claims that it failed to catch signs of fraud that helped lead to one of the biggest U.S. bank collapses during the Great Recession. The trial in Florida state court in Miami is one of the few allegations of wrongdoing during the financial crisis that has reached a courtroom.

The closely watched case could lead to billions of dollars in damages depending on how a jury answers a fundamental question in accounting: How much responsibility do auditors have for catching fraud?

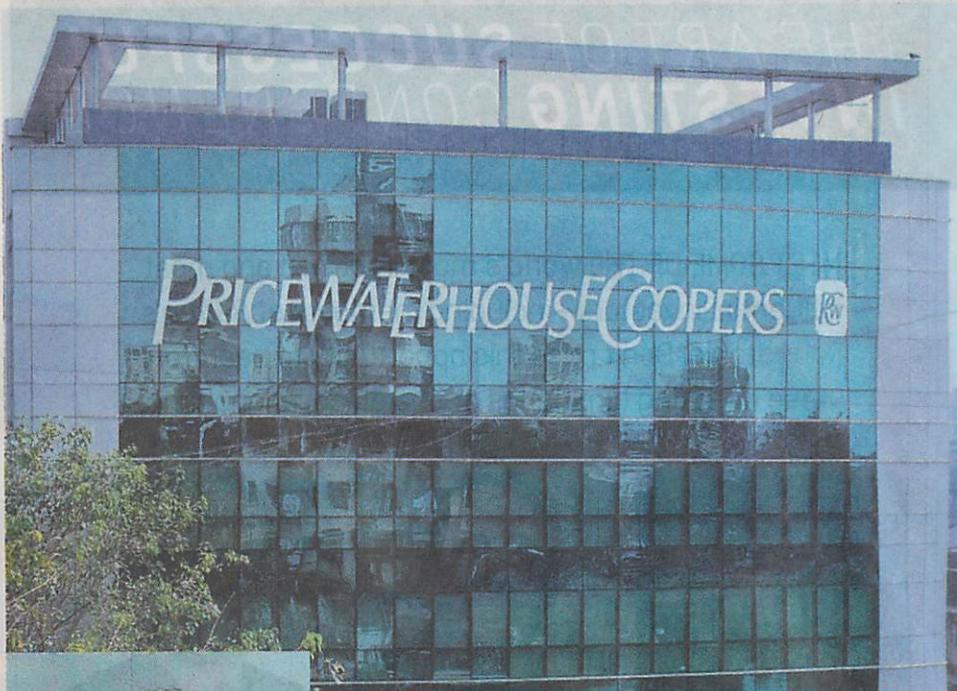
The bankruptcy trustee for **Taylor Bean & Whitaker Mortgage Corp.**, once one of the nation's biggest privately held mortgage companies, is suing PwC, seeking \$5.5 billion in damages. The trustee alleged in the 2013 suit that PwC was negligent in not detecting a massive fraud scheme that brought down Taylor Bean and helped trigger the 2009 collapse of Colonial Bank, a Montgomery, Ala., bank with \$25 billion in assets.

The trial is expected to last about six weeks. Such a trial isn't only rare—most crisis-related legal probes have ended in settlements at most—but it is also one of the few attempts to hold auditors liable for events stemming from the meltdown.

"This is basically holding an auditor responsible for its failure to do its job," said Steven W. Thomas, an attorney representing Neil Luria, the Taylor Bean trustee.

Elizabeth Tanis, an attorney for PwC, said the accounting firm did its job properly and is "confident that a jury will understand the applicable rules and standards in this case and decide accordingly."

The Taylor Bean trustee



Lee Farkas, below, was convicted of fraud charges in 2011.

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Taylor Bean, a major customer of Colonial, had been over-drawing its Colonial account since 2002 to cover its own cash shortfalls. Taylor Bean covered that up by, among other things, selling Colonial fake pools of mortgages and thousands of mortgages it had already sold to other investors, authorities say.

After the fraud was discovered, Taylor Bean filed for bankruptcy in August 2009. Colonial failed that month also, costing federal regulators' deposit-insurance fund an estimated \$3.3 billion. In addition to Mr. Farkas, five other Taylor Bean executives and two Colonial employees pleaded guilty to participating in the scheme.

The trustee representing Taylor Bean creditors contends PwC should have uncovered the fraud and thus prevented the losses. The fraud "was staring them in the face," Mr. Thomas said. In court papers, the trustee argues that PwC, among other things, failed to audit billions of dollars of transactions, failed to certify assets and relied on unsigned contracts.

PwC argues that it was deceived and shouldn't have been expected to catch the Taylor Bean fraud when neither bank regulators nor Colonial or Taylor Bean did. The Taylor Bean trustee now "seeks a second helping" of funds it was never entitled to in the first place, PwC claimed in court papers.

Under auditing rules, PwC adds it isn't actually an auditor's job to find fraud. Ms. Tanis said the rules make clear that "even a properly designed and executed audit may not detect fraud, especially in instances where there is collusion, fabrication of documents, and the override of controls, as there was at Colonial Bank."

The Miami trial isn't the only one PwC may face over Taylor Bean. Colonial BancGroup's bankruptcy trustee and the Federal Deposit Insurance Corp. have sued PwC and Crowe Horwath LLP, Colonial's internal auditor, in federal court in Alabama, and those cases are scheduled to go to trial in February. Crowe Horwath and the FDIC declined to comment; an attorney for the Colonial trustee couldn't be reached.

contends that PwC should have found the fraud even though it wasn't Taylor Bean's auditor. PwC was the outside auditor for Colonial's holding company, Colonial BancGroup Inc. Taylor Bean's auditor, Deloitte & Touche LLP, reached a confidential settlement with the trustee in 2013 over related allegations. Deloitte declined to comment.

Prosecutors have said the fraud was led by Lee Farkas, Taylor Bean's chairman, who was convicted on fraud charges in 2011 and is now serving a 30-year prison sentence in Butner, N.C.

According to authorities,