IN THE MISSOURI SUPREME COURT

CHILDREN'S WISH FOUNDATION INTERNATIONAL, INC.,	)	
	)	
Appellant,	)	
	)	
v.	)	**Case No. SC90944**
	)	
MAYER HOFFMAN MCCANN P.C. AND CBIZ ACCOUNTING, TAX & ADVISORY OF KANSAS CITY, INC.,	)	
	)	
Respondents.	)	

On Appeal From The Circuit Court Of Jackson County, Missouri
Sixteenth Judicial Circuit
The Honorable Robert M. Schieber

RESPONDENTS' SUBSTITUTE BRIEF

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JURISDICTIONAL STATEMENT

Respondents Mayer Hoffman McCann P.C. and CBIZ Accounting, Tax & Advisory of Kansas City, Inc. do not object to the Jurisdictional Statement of Appellant Children's Wish Foundation International, Inc.

STATEMENT OF FACTS

This case concerns the financial statements and the tax return of Appellant Children's Wish Foundation International, Inc. ("CWF") for the fiscal year ending June 30, 1999. As it had for a number of years, Respondent Mayer Hoffman McCann P.C. ("MHM") provided auditing services in connection with CWF's financial statements for that fiscal year. Respondent CBIZ Accounting, Tax & Advisory of Kansas City, Inc. ("CBIZ") assisted in the preparation of CWF's tax return, also known as an IRS Form 990, for that fiscal year. The Statement of Facts submitted by CWF is incomplete because it does not include facts that show how its own negligent conduct gave rise both to its alleged injury and to the jury instruction at issue in this case. Thus, MHM and CBIZ submit the following facts for the Court's consideration.

A. Background on CWF and events leading to the audit

CWF is a Georgia not-for-profit organization headquartered in Atlanta. (Legal File ("LF") at 21 ¶ 1.) It is engaged in raising funds to grant wishes and provide enrichment programs to seriously ill children. (*Id.*) It is not related to the more widely known Make-A-Wish Foundation. The management team of CWF consists of Arthur Stein and Linda Dozoretz, who are husband and wife. (Trial Transcript ("Tr.") 27.) Stein is the President of the organization, and Dozoretz is the Executive Director. (*Id.* at 384.)

Stein and Dozoretz ran the organization and made all the decisions. (*Id.* at 95-96; Ex. 1311, Christy Andrews testimony at 48-51.)[1]

Charities such as CWF live a "beauty pageant" existence in which they are evaluated on the amount of their fundraising expenses. (Tr. 115-17.) These expenses are expressed as a charity's "cost to raise a dollar," or the ratio between what the charity spends on program services and on fundraising. (*Id.*) A high cost to raise a dollar or "ratio" subjects a charity to criticism or disapproval by the public, corporate donors, and the media, as well as to low ratings by watchdog organizations such as the Better Business Bureau, the American Institute of Philanthropy, GuideStar, and Charity Navigator. (*Id.* at 12, 115-17, 185, 195, 620.) A high ratio creates the impression that a charity is not spending enough money on program services and thus is "not necessarily a worthy organization." (*Id.* at 117.)

CWF traditionally has had a very high cost to raise a dollar. (*Id.* at 489-90.) CWF's ratio is higher than other charities' because CWF has always used telemarketing to raise money. (*Id.* at 11-12; Ex. 1311, Carmichel testimony at 49-53.) Telemarketing is very expensive. (Tr. at 395-96.) From 1997 to 2000, CWF paid at least 76 cents out of every dollar it raised through telephone solicitations to a third party telemarketer. (Trial

[1] Exhibit 1311 is a CD containing the portions of certain videotaped depositions that were played at trial. By stipulation, the transcripts accompanying these videos have been submitted for the Court's convenience. Page citations for Exhibit 1311 refer to these transcripts.

Exhibit ("Ex.") 1308 at 2.) From 1987 through 2007, CWF never had more than approximately 11% of its gross revenue available to grant wishes to children, because it spent the remaining percentage on administrative, salary, fundraising, and other expenses. (Tr. at 584-85 & Ex. 1298.) CWF's high fundraising costs were perceived as excessive by regulatory and oversight organizations and posed a threat to CWF's existence. (Ex. 210A at 4; Tr. at 364-66 (comments in Ex. 210A were made by CWF participants).)

In March 1998, a new accounting rule, Statement Of Position ("SOP") 98-2, was issued. (Tr. 361.) Consultants advised CWF that SOP 98-2 would adversely affect the organization's ratio because it would require CWF to record certain types of expenses as fundraising costs instead of program services. The new rule "could cause a significant shift of costs from CWF program services to fund raising in the annual external financial reports and information returns filed with the Internal Revenue Service." (Ex. 212 at 1 & Tr. 367; Ex. 210A at 1 & Tr. 359, 363; Tr. 185-86.) This threatened to drive CWF's publicly-reported cost to raise a dollar even higher.

In response to the impending rule change, Stein and Dozoretz dramatically expanded CWF's "gifts in kind" program. (Tr. 559.) Gifts in kind are non-cash donations such as books or toys. Such donations "reduce the cost to raise a dollar" (*id.* at 398) and were not subject to SOP 98-2. Stein obtained gifts in kind – which CWF shipped to hospitals and Ronald McDonald Houses – by ordering them through two clearinghouses known as Gifts In Kind International ("GIKI") and the National Association for Exchange of Industrial Resources ("NAEIR"). (*Id.* at 197, 243-44; Ex. 38 at 6 ¶¶ 11-12.) For the fiscal year in issue, Stein increased CWF's orders of gifts in kind more than ten

times over the amount the previous year from approximately $500,000 in the fiscal year ending June 30, 1998 to $5.5 million in the fiscal year ending June 30, 1999. (Tr. 243; Ex. 38 at 9 ¶ 25.)

CWF employee Leslie Biegelsen recorded gift in kind shipments, calculating and recording in spreadsheets the values of shipments to hospitals and Ronald McDonald Houses. (Ex. 1311, Biegelsen testimony at 69-70; Ex. 113A; Ex. 113B.) Biegelsen usually worked on the spreadsheets from her home in Tampa, Florida rather than in CWF's office in Atlanta. (*Id.* at 31-33.) The increased volume of gifts in kind in 1998 and 1999 "overwhelmed" Biegelsen, and it was "kind of obvious" within CWF that the organization did not have adequate procedures. (Ex. 1311, Andrews testimony at 27, 31-32; *see also* Ex. 1311, Azer-Barron testimony at 99 (warehouse was so "jam-packed" with merchandise that CWF employees "could barely walk in it").)

B. MHM's audit work

In August 1999, Jeff Carlstedt and other MHM auditors from Kansas City arrived at CWF's headquarters in Atlanta to do audit field work for the fiscal year ending June 30, 1999. (Tr. 741-42, 748-49.) Shortly after their arrival, Carlstedt and others learned for the first time that CWF's gifts in kind had increased during the past year by a factor of ten. (*Id.* at 749.) By the time the auditors arrived, CWF had already shipped out most of the gifts in kind it had received. (*Id.* at 750.) This presented MHM auditors with a problem. (*Id.*)

MHM asked Dozoretz to provide documentation showing the gifts in kind CWF shipped to hospitals and Ronald McDonald Houses during the past fiscal year. (*Id.* at

753-54; Ex. 941 at MHM 00516 (number 13).) Dozoretz provided certain UPS shipping documents, certain thank-you notes from hospitals and Ronald McDonald Houses, and the spreadsheets with quantities and values that had been compiled by Biegelsen and others. (Tr. 757-59; Ex. 113A; Ex. 113B.) CWF provided all of the gift in kind quantities and values in the spreadsheets. (Tr. 759-60, 763, 806; Ex. 1318 at 104-05.) MHM also requested that CWF provide documentation showing the quantity and value of gifts in kind CWF had received during the past fiscal year. (Tr. 754; Ex. 941 at MHM 00516 (number 23).) Dozoretz provided a chart entitled "Gifts in Kind," and represented to MHM auditors that it reflected the values of the gifts in kind CWF had received from GIKI, NAEIR, and other sources. (Tr. 311-12, 313-14, 335, 340, 766, 812-13; Ex. 85J.)

Because of the substantial increase in gifts in kind, MHM auditors expanded their audit plan. (Tr. 749-50.) Carlstedt and the MHM team similarly expanded audit procedures when they discovered an error in the value of certain "Miss Piggy" cookbooks that remained in CWF's inventory at the time of the audit field work. (*Id.* at 296-97, 333.) The expanded audit procedures included obtaining confirmations from GIKI and NAEIR, the clearinghouses from which CWF had obtained most of its gifts in kind. (*Id.* at 333-34.)

After GIKI and NAEIR declined for privacy reasons to provide valuation statements from the original donors of the merchandise (tax documents known as IRS Forms 8283), MHM determined that an appropriate course of action was for CWF to seek confirmation letters. (*Id.* at 771, 773-74, 826-27, 196-99; Ex. 93.) CWF asked GIKI and NAEIR to send letters to MHM confirming the quantities and values reflected in the Gift

in Kind chart (denoted "P-40") that Dozoretz had provided to MHM. (Ex. 85N & Ex. 940 at MHM00282 (GIKI letter); Ex. 85O & Ex. 940 at MHM 00283 (NAEIR letter); Ex. 85J at 1 ("P-40"); Tr. 298-300, 338-39, 771-73.) With this Gift in Kind chart in hand, GIKI provided the following confirmation: "As to the question of the merchandise received from Gifts In Kind, our records do not appear to contradict the information that you have supplied." (Ex. 85N.) NAEIR provided the same confirmation. (Ex. 85O.)[2]

As it turned out, the Gift in Kind chart denoted P-40 was in error. The chart displayed the quantities and values only of gifts in kind that CWF had *ordered*, not of gifts in kind that CWF had actually *received*. As an example, the chart showed 17 pallets of Miss Piggy cookbooks worth $693,175, even though CWF had only received seven pallets of these books – and because most of the pallets had been shipped out, MHM could not physically count them. (Tr. 307-08; Ex. 85J at 2; Tr. 224-25, 252-53; Ex. 1148 at 1.) CWF used the values reflected in the chart – which GIKI and NAEIR had confirmed – in connection with its financial statements. (*Compare* Ex. 85J at 1 (adjusted in-kind donations of $4,024,398) *with* Ex. 1282 at 12 (showing the same number in the financial statements, excluding wish items and automobiles).) As it was also discovered after the completion of the audit, CWF used the values reflected in the chart to determine or "plug" the value in the spreadsheets of outbound shipments of gifts in kind. (Tr. 224-

[2] In addition to obtaining confirmation of the gifts in kind CWF had received, MHM confirmed that CWF had made outbound shipments by (among other things) reviewing thank-you notes from gift in kind recipients. (Tr. 764-65.)

25, 227-28, 232-33, 255-58, 259-60; Ex. 113A; Ex. 113B.) CWF used the values in the Ronald McDonald House spreadsheet in connection with its tax return. (Tr. 806, 259-60.)

Dozoretz provided MHM with the false information in the Gift in Kind chart and the spreadsheets despite having been informed by CWF staff during the year of the actual gift in kind figures. Along with an assistant in the CWF warehouse, Bancroft counted gifts in kind as they came in. (Ex. 1311, Bancroft testimony at 44-45; Ex. 1311, Hooks testimony at 78-79.) Bancroft compared the number of gift in kind items that had been received to the number of gift in kind items that had been ordered, made notations on the order forms, and reported discrepancies to Stein and Dozoretz. (Ex. 1311, Hooks testimony at 79-80, 83-85.) Bancroft also signed a "waybill" that identified the number of pallets that had been delivered. (Ex. 1311, Bancroft testimony at 43-45; *see also* Ex. 1311, Azer-Barron testimony at 18-20, 41-42 (Stein gave his assistant bills of lading that showed the quantities of gifts in kind that had been received).) The waybill for the Miss Piggy books – which Bancroft signed on January 6, 1999 – showed in the column entitled "# PCS" that 7 pallets had been received. (Ex. 568; Tr. 563.) Bancroft provided copies of waybills to Stein or Dozoretz. (Ex. 1311, Bancroft testimony at 45-47.) Instead of providing these waybills to MHM, Dozoretz provided the auditors with a gift in kind list of pallets ordered to show what CWF received. (Tr. 375.)

CWF agreed in the written engagement letter that the organization was responsible not just for "making all financial records and related information" available to MHM, but also for "the accuracy and completeness of that information." (Tr. 498-500, 564; Ex. 69

at 2.) The engagement letter was consistent with the principle that management is responsible for an organization's financial statements, for compliance with Generally Accepted Accounting Principles ("GAAP"), for maintaining adequate records and controls, and that management is ultimately responsible for the organization's tax return. (Tr. 271, 327, 376-77; Ex. 1304.)

CWF repeated many assurances to MHM in a management representation letter. Stein and Dozoretz represented to MHM in writing that they had made available all financial records and related data. (Ex. 68 at 1.) But they had not done so. Stein and Dozoretz provided specific written assurance regarding the gift in kind values that had been furnished to MHM and included in CWF's financial statements: "We have reviewed the nature of the in-kind contributions and the valuations methods used for those contributions. We believe the in-kind contributions have been fairly presented in the financial statements." (*Id.*; Tr. 329-30, 503-06.) The management representation letter was "one of the most important things" MHM obtained during the audit, and MHM placed "a lot of reliance on the fact that we have an honest client, that we've got a client that's forthright with us throughout the course of the engagement." (Tr. 327-28; *see also id.* at 271 (preparer can only do as good a job as the information provided by management).)

Even though MHM received written and verbal assurances from Stein and Dozoretz, MHM still took steps to verify and avoid any overstatement of CWF's gift in kind numbers. As noted above, MHM recommended that CWF obtain third party confirmation letters from GIKI and NAEIR, two independent organizations with no

incentive to misstate CWF's inventory. Those third party confirmations provided one of the highest levels of audit assurance. (Tr. 299, 334, 825-26, 875, 909.) MHM also recommended that CWF take a conservative approach, an approach that led to CWF writing down the value of its gifts in kind by more than $1 million. (*Id.* at 248-50, 565-67, 766-70, 780-81, 823-24; Ex. 38 at 6 ¶ 17; Ex. 85J.)

C. The Pennsylvania Order To Show Cause

In October 2000, the Commonwealth of Pennsylvania filed an Order To Show Cause against CWF. (Ex. 27 at 1.) Counts 1-41 of the Order To Show Cause alleged errors in CWF's tax return regarding the values of gifts in kind that had been shipped to Ronald McDonald Houses. (*Id.* at 3-5.) Counts 42-95 in the Order To Show Cause alleged that Stein and Dozoretz had acted in a manner that was inconsistent with CWF's charitable purpose by using donations for travel expenses (including trips to England, Scotland, Ireland, Puerto Rico, Aruba, Switzerland, the Netherlands, Germany, and Austria) and gifts (including cosmetics, decanters, an ornamental horse, and sleepwear from Victoria's Secret). (*Id.* at 5-36.)

The Order To Show Cause followed years of investigation. Pennsylvania began investigating CWF in 1991, and entered into a Consent Decree with the organization in 1995. (Tr. 77, 126-27; Ex. 13.) In 1997, Pennsylvania began investigating CWF again, and continued making requests for information every year thereafter. (Tr. 413-17; Ex. 21.) By October 2000, because Pennsylvania had invested "so much time and money" into the investigation, CWF and its counsel anticipated "some type of assertion or

deficiency as a justification for recouping costs and fees." (Ex. 104 at 1; Tr. 183-84; Ex. 1311, Carmichel testimony at 34-35.)

CWF hired Ricardo Zayas, a forensic accountant, to examine the organization's gift in kind records in light of the Order To Show Cause. (Tr. 238-40.) Zayas concluded that the overstatements in the values of the gifts in kind CWF had received (approximately $1.31 million) and shipped out (approximately $1.23 million) "in large part" cancelled each other out, so that after making a further adjustment the net effect on the tax return was a $26,699 write down. (*Id.* at 234-35, 263-64; Ex. 122 at 2.) CWF's gross revenue for that fiscal year was at least $25 million. (Tr. 511, 334.) CWF's successor auditor filed an amended tax return, but concluded there was not a material error that required a restatement the organization's financial statements. (*Id.* at 346-47, 852-56, 878-79, 896-97.)

Accordingly, one of CWF's defenses to the Order To Show Cause was that the gift in kind errors were not material. (Tr. 177, 184.) Relying on the standards for materiality set forth by the Financial Accounting Standards Board and the Securities and Exchange Commission, CWF argued that the gift in kind errors were immaterial because they improved the organization's cost to raise a dollar ratio by only 1.7%, did not affect the organization's "bottom line," and did not affect donor behavior. (*Id.* at 48-50, 54-55 & n.7.) The Pennsylvania hearing examiner did not apply GAAP standards of materiality and ruled against CWF. (Tr. 205.)

ARGUMENT

I. CONTRIBUTORY NEGLIGENCE IS AND SHOULD BE A RECOGNIZED DEFENSE IN AUDITING AND ACCOUNTING CASES INVOLVING ONLY ECONOMIC LOSS. (RESPONDS TO APPELLANT'S SUBSTITUTE BRIEF §§ I.A-F)

"Whether a jury was properly instructed is a question of law that this Court reviews *de novo*." *Bach v. Winfield-Foley Fire Prot. Dist.*, 257 S.W.3d 605, 608 (Mo. banc 2008). Appellate courts review the instruction "in a light most favorable to the party offering the instruction and in support of the verdict." *Steenrod v. Klipsch Hauling Co.*, 789 S.W.2d 158, 164 (Mo. App. E.D. 1990).

An instructional error warrants reversal "only if the error resulted in prejudice that materially affects the merits of the action." *Bach*, 257 S.W.3d at 608. Because "[r]etrials are burdensome," there has been "a trend away from reversal for error in instruction, unless there is a substantial indication of prejudice." *Fowler v. Park Corp.*, 673 S.W.2d 749, 757 (Mo. banc 1984); *see also Lindquist v. Scott Radiological Group, Inc.*, 168 S.W.3d 635, 644 (Mo. App. E.D. 2005) (stating that "[c]ourts should not overturn a jury verdict lightly" because of the costs to "the litigants, the jurors and tax-payers") (citation omitted). Instructional error is therefore "no longer an automatic ground for reversal; rather, instructional error stands as a ground for reversal only where the record on appeal indicates substantial prejudice." *Citizens Bank of Appleton City v. Schapeler*, 869 S.W.2d 120, 128 (Mo. App. W.D. 1993).

A. In The 27 Years Since *Gustafson*, The Appellate Courts Of Missouri Have Consistently Applied The Doctrine Of Contributory Negligence To Cases Involving Only Economic Damages. (Responds to § I A-C)

From the earliest days of statehood, Missouri courts have recognized contributory negligence as a defense in professional negligence cases. *See, e.g., Benton v. Craig*, 2 Mo. 198 (1830); *Carr's Executrix v. Glover*, 70 Mo. App. 242 (1897). In 1983, this Court adopted a comparative fault regime for certain types of cases. *Gustafson v. Benda*, 661 S.W.2d 11, 12-16 (Mo. banc 1983). The Court directed Missouri courts to apply comparative fault "insofar as possible . . . in accordance with the Uniform Comparative Fault Act," and attached to its opinion a copy of the Act with the Commissioners' comments. *Id.* at 15-16.

Both the Act (or "UCFA") and the comments make clear that principles of comparative fault only apply to cases involving personal injury or property damages. Section 1(a) of the UCFA states: "In an action based on fault seeking to recover damages for injury or death to person or harm to property, any contributory fault chargeable to the claimant diminishes proportionately the amount awarded as compensatory damages for any injury attributable to the claimant's contributory fault, but does not bar recovery." *Id.* at Appendix A, § 1(a) (emphasis added). The Commissioners' comments to § 1(a) further confirm that economic harm, as opposed to harm to person or property, is not included:

> Harms Covered. The specific application of the principle, as provided for in this Act, is confined to physical harm to person or property. . . . It does

> not include matters like economic loss resulting from a tort such as negligent misrepresentation, or interference with contractual relations or injurious falsehood, or harm to reputation resulting from defamation. But failure to include these harms specifically in the Act is not intended to preclude application of the general principle to them if a court determines that the common law of the state would make the application.

Id. § 1(a) cmt.

The Commission on Uniform State Laws drew a distinction between cases involving physical harm to a person or damage to property – to which it applied the comparative fault principles – and matters such as torts involving economic loss – to which it declined to apply principles of comparative fault. Recognizing that economic loss cases are different from those involving physical harm or damage to property, it left the issue up to development by common law. Since *Gustafson*, the Court of Appeals has consistently refused to apply comparative fault principles to matters involving only economic loss.

The Court of Appeals has considered and rejected the arguments CWF puts forward here seeking an expansion of comparative fault beyond the realm of physical harm. Including the comprehensive 56-page opinion of the Western District in this case, now transferred here, each district of the Court of Appeals has held that comparative fault does not apply in cases involving solely economic loss. *See, e.g.*, *Roskowske v. Iron Mountain Forge Corp.*, 897 S.W.2d 67, 73 (Mo. App. E.D. 1995) ("Comparative fault does not apply to a case involving purely economic damages."); *Chicago Title Ins. Co. v.*

Mertens, 878 S.W.2d 899, 902 (Mo. App. E.D. 1994) ("Nothing in the UCFA indicates that comparative fault should apply in a case involving only economic damages."); *Murphy v. City of Springfield*, 738 S.W.2d 521, 529-30 (Mo. App. S.D. 1987) (holding that "comparative fault is not applicable" outside of cases involving "physical harm"). Specifically, the Court of Appeals has held as well that contributory negligence remains a defense in accounting and auditing cases involving alleged economic loss. In *Miller v. Ernst & Young*, 892 S.W.2d 387 (Mo. App. E.D. 1995), for example, the plaintiffs alleged that the defendants negligently failed to conduct an audit and to discover falsified records. *Id.* at 388. The court confirmed that "[i]n this case involving only economic damages, contributory negligence remains an absolute defense." *Id.* at 388 n.1.

CWF asserts that *Chicago Title* and *Murphy* assumed the UCFA creates substantive law and ignored considerations of fairness and equity. Appellant's Substitute Brief ("Aplt. Subst. Br.") at 22-23. They did neither. Both cases expressly acknowledge this Court's observations in *Lippard v. Houdaille Industries, Inc.*, 715 S.W.2d 491 (Mo. banc 1986), that the UCFA is "merely to serve as a guide" which is not to be treated as "a statute of the State of Missouri." *Chicago Title*, 878 S.W.2d at 902; *see Murphy*, 738 S.W.2d at 529-30 (quoting *Lippard* at length). Similarly, they acknowledge that *Gustafson* "was intended to mitigate the harshness of the doctrine of contributory negligence." *Murphy*, 738 S.W.2d at 529 (citation omitted). Yet taking all this into account, these cases still conclude – correctly – that Missouri has not adopted and should not adopt a blanket rule of comparative fault that applies in cases involving economic loss:

> Generally, comparative fault was adopted for Missouri in *Gustafson*. . . . *Lippard* indicates that the Uniform Comparative Fault Act is not to be literally followed, and the commissioner's comments less so, but we doubt that Missouri will apply comparative fault any broader than the Act. We look to it and the comments for guidance . . . . Here, the loss was not from physical harm and this action, if not based on negligent misrepresentation, is closely related to it. For those reasons we conclude that comparative fault is not applicable.

Id. at 529-30 (footnote omitted); *see also Roskowske*, 897 S.W.2d at 73 ("[C]omparative fault has never been applied uniformly in Missouri law. It was adopted only insofar as possible.") (citation, brackets, and internal quotation marks omitted).

CWF argues that in *Dalton & Marberry, P.C. v. Nationsbank, N.A.*, 982 S.W.2d 231 (Mo. banc 1999), the Court "implicitly recognized" that comparative fault applies in this type of action. Aplt. Subst. Br. at 27. It did not. In *Dalton & Marberry* the plaintiff brought an action claiming a bank negligently failed to inquire about plaintiff's employee's authority to obtain funds from the plaintiff's bank account. 982 S.W.2d at 232. *Dalton & Marberry* thus turned on banking law and the Uniform Commercial Code ("U.C.C."). It was brought under a theory espoused in a 1949 case that foreclosed a bank from using a defense of negligence by a depositor. *Id.* at 232, 237 (citing *Martin v. First Nat. Bank in St. Louis*, 219 S.W.2d 312 (Mo. 1949)). *Dalton & Marberry* did not apply the doctrine of comparative fault as CWF argues. Instead, it held that the jury should hear the evidence of the depositor's fault so that the jury could make a determination of

causation – that is, the point at which the depositor was responsible for the loss. As the Court put it:

> Nevertheless, the customer's failure to protect its own interests, and to follow generally accepted business practices, undoubtedly can cause or contribute to cause some of the customer's losses. When we adopt a comparative approach we do not suggest that a jury be asked to apportion losses by percentages. The jury would determine at what point in time a reasonable customer would have discovered the scam and prevented further losses, allocating to the bank those losses occurring before that point in time. In other words, the jury would determine which losses were proximately caused by the bank's breach of duty (and which were not) of the 93 checks presented by Hollandsworth and paid by the bank in the four and one-half year period.

982 S.W.2d at 237 (emphasis added). Thus, the negligence of the depositor – Dalton & Marberry – operated as a complete bar to its recovery after the point at which it could have discovered the employee's embezzlement. *Dalton & Marberry* does not signal an "implicit" recognition by this Court that comparative fault principles apply in cases of economic loss as CWF suggests.[3]

[3] Nor does *Gramex Corp. v. Green Supply, Inc.*, 89 S.W.3d 432 (Mo. banc 2002), signify a rejection by this Court of contributory negligence in economic loss cases. As part of a background discussion, the Court stated, "Until 1983, a plaintiff's recovery in a

B. Appellant Provides No Justification For Reversing Settled Precedent And Eliminating Contributory Negligence As A Defense In Economic Loss Cases. (Responds to § I C-D)

CWF admits that "[t]his Court has not directly addressed the issue of whether contributory negligence continues to act as a complete bar to recovery in a negligence action involving only economic damages." *Id*. at 26. Later, CWF argues that it "appears" that in *Gustafson*, *Lippard*, and *Gramex*, "this Court has already determined that comparative fault applies in all types of negligence actions and that contributory fault no longer serves as complete bar to recovery in any type of negligence action." Aplt. Subst. Br. at 30. Nothing in the *Gustafson*, *Lippard* or *Gramex* cases – none of which involved only economic loss – abolishes the doctrine of contributory negligence in economic loss cases. The policy reasons not to abolish the defense in professional negligence cases are equally compelling.

1. This Court has not abolished contributory negligence as a defense in economic loss cases.

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negligence action was subject to the doctrine of contributory negligence." *Id*. at 439. The appeal dealt with a challenge to rulings of the trial court and sufficiency of the evidence on a cross-claim for contribution. *Id.* at 441-43. The Court was not asked to analyze the issue presented in this case, and the statement hardly constitutes a holding that contributory negligence is no longer a defense.

CWF asserts that the opinions in *Missouri Pacific Railroad Co. v. Whitehead & Kales*, 566 S.W.2d 466 (Mo. banc 1978), and *Gustafson* support the conclusion that contributory negligence is no longer a recognized defense in Missouri. Aplt. Subst. Br. at 31. But neither case stands for this proposition, as shown by the post-*Gustafson* decisions of every district of the Court of Appeals. The Court of Appeals has repeatedly declined to extend comparative fault to professional negligence cases resulting in solely economic loss. *See, e.g.*, *Roskowske*, 897 S.W.2d at 73 ("Comparative fault does not apply to a case involving purely economic damages."); *Miller*, 892 S.W.2d at 388 n.1 ("In this case involving only economic damages, contributory negligence remains an absolute defense."); *Chicago Title*, 878 S.W.2d at 902 ("Nothing in the UCFA indicates that comparative fault should apply in a case involving only economic damages."); *Murphy*, 738 S.W.2d at 529-30 (holding that "comparative fault is not applicable" outside of cases involving "physical harm"). This Court should reject CWF's assertion that the numerous judges of the Court of Appeals who wrote or joined in these opinions all misread *Gustafson.*

2. Policy considerations do not favor the expansion of comparative fault principles that CWI seeks.

a. Any expansion of comparative fault should be implemented by the Legislature, not by the Judiciary.

Even if there were a compelling reason to ignore existing case law and extend comparative fault to claims involving purely economic losses, that is a step for the

legislative rather than the judicial branch. It is true that prior to *Gustafson*, this Court had occasion to act in circumstances where the General Assembly had not yet changed outmoded law. *See, e.g.*, *Abernathy v. Sisters of St. Mary's*, 446 S.W.2d 599, 605-06 (Mo. banc 1969) ("It is neither realistic nor consistent with the common law tradition to wait upon the legislature to correct an outmoded rule of case law."); *Anderson v. Cahill*, 528 S.W.2d 742, 749 (Mo. banc 1975) (Donnelly, J. concurring) (asserting that under *Abernathy* "I do not believe we need defer to the General Assembly"). This view was reflected in *Gustafson*, in which the Court noted that it had "remained quiescent" and "wait[ed] for the legislature to act" during the five-year period following *Whitehead & Kales* "and its newly adopted concept of comparative fault." 661 S.W.2d at 14-15.

The rare circumstances that prompted this Court to act in *Gustafson* are no longer present. Since *Gustafson*, the General Assembly has demonstrated its willingness to address issues relating to contributory negligence and comparative fault. In *Lippard*, this Court held that comparative fault principles did not apply to strict products liability cases, and invited legislative action in the event of any disagreement. *See* 715 S.W.2d at 494 ("If there is dissatisfaction with our conclusion, the state and national legislatures may be addressed."). The General Assembly promptly enacted legislation providing that "[c]ontributory fault, as a complete bar to plaintiff's recovery in a products liability claim, is abolished. The doctrine of pure comparative fault shall apply to products liability claims as provided in this section." R.S. Mo. § 537.765(1). The Missouri legislature also enacted R.S. Mo. § 537.067, which allocates liability among defendants depending on the level of fault. The enactment of §§ 537.765 and 537.067 demonstrates that the General

Assembly (1) is capable of monitoring and shaping the law of negligence; (2) knows how to abolish contributory negligence for certain types of claims; and (3) knows how to adopt comparative fault for certain types of claims.

Accordingly, the idea that legislative action is too uncertain or too slow is no longer sufficient to justify judicial expansion of comparative fault – particularly after 27 years of uniform post-*Gustafson* decisions by the Court of Appeals. "Broad policy issues are the legislature's business. The question of comparative fault is, and has always been, one for the General Assembly." *Lippard*, 715 S.W.2d at 497 (Robertson, J. concurring); *see also Gustafson*, 661 S.W.2d at 29 (Gunn, J., dissenting) (stating that "imposition of comparative negligence or fault is not a matter for judicial fiat"). The reasons are manifold for assigning responsibility for any expansion of comparative fault to the legislature:

> The legislative process has a superior capability for getting the input of the finest legal scholars, the best trial lawyers, and the consumer public in determining the system of tort law best adapted to our present day social and economic needs. No area of the law cries out more for a clear policy established by democratically elected representatives.

Steinman v. Strobel, 589 S.W.2d 293, 295 (Mo. banc 1979) (Welliver, J. concurring) (citation and internal quotation marks omitted); *see also Gustafson*, 661 S.W.2d at 29 (Rendlen, C.J., dissenting) (stating that complex policy issues relating to comparative and contributory negligence require "a systematic approach best suited for resolution by the legislative branch").

That the expansion of comparative fault is primarily a legislative prerogative is evident from a review of other states' laws. When *Gustafson* was decided, 32 out of the 40 states that had adopted comparative fault had done so by legislation instead of judicial decision. 661 S.W.2d at 13 n.9; *see also Harrison v. Montgomery County Bd. of Educ.*, 456 A.2d 894, 901 (Md. 1983) ("[M]ost of the states which have adopted comparative negligence have done so by statute in derogation of the common law."); *Golden v. McCurry*, 392 So.2d 815, 817 (Ala. 1980) (observing that a "great majority" of comparative fault jurisdictions have "statutory provisions expressly imposing the doctrine") (citation omitted). Since that time, more states have adopted comparative fault by statute, rather than by judicial edict. *See, e.g.*, Ariz. Rev. Stat. Ann. §§ 12-2501 to 12-2509 (1993); Del. Code Ann., tit. 10, § 8132 (1984); Ky. Rev. Stat. Ann. § 411.182 (1988). Furthermore, several of the state courts which have followed the same path as Missouri in declining to mandate a blanket rule of comparative fault have recognized that "[i]n the final analysis, whether to abandon the doctrine of contributory negligence in favor of comparative negligence involves fundamental and basic public policy considerations properly to be addressed by the legislature." *Harrison*, 456 A.2d at 905; *see also Golden*, 392 So.2d at 817 ("[E]ven though this Court has the inherent power to change the common law rule of contributory negligence, it should, as a matter of policy, leave any change of the doctrine of contributory negligence to the legislature.").

b. Professional negligence cases involving auditing and accounting are particularly suited to a narrowly tailored contributory negligence defense.

CWF contends that "fundamental considerations of fairness and equity require application of comparative fault in negligence actions that involve only economic damages." Aplt. Subst. Br. at 33. In asking this Court to expand comparative fault principles to economic loss cases, CWF urges the Court to make sweeping changes that reach far beyond the professional negligence issue presented here. CWF asks the Court to broadly declare that contributory negligence is not a defense to *any* negligence claim in which the damages are solely economic. Aplt. Subst. Br. at 35. But this case does not involve an ordinary negligence claim. Instead, CWF alleged professional negligence by MHM and CBIZ with respect to accounting and auditing services for which CWF contracted with the respondents. Thus, the case before this Court represents a small subset of negligence claims – those in which the allegedly negligent conduct is specifically addressed by a professional services contract.

Economic loss negligence cases most often – as here – arise out of a contractual or quasi-contractual relationship. As one commentator has noted, the UCFA

> does not cover suits to recover purely economic loss, such as actions that are fully contractual in their gravamen, in which the plaintiff is suing solely because the plaintiff did not recover what the plaintiff contracted to receive, or suits for negligent misrepresentation, interference with contractual relations, injurious falsehood, or defamation.

3 R.E. Kaye, *Comparative Negligence* § 19.10[3], at 19-12 (2004).[4] When economic loss cases arise in contract, excluding economic damages cases from the UCFA's application makes sense because the parties can allocate risks and duties in the contract. *Id.* Although professionals have some duties imposed by law which cannot be contractually avoided, there remain substantial reasons why economic loss cases cannot be equated with garden variety negligence actions.

As a result, there is no merit to CWF's suggestion that "there is no good reason to apply contributory negligence in negligence actions that involve only economic damages when contributory negligence is not applied in other types of negligence cases." Aplt. Subst. Br. at 23-24, 35. Putting aside the point that the Commission on Uniform State Laws clearly saw reason to distinguish economic loss cases by expressly excluding them from the UCFA in favor of state-by-state resolution, CWF's argument ignores the

[4] Some economic loss cases also differ from traditional negligence cases because they are subject to the economic loss doctrine. *See, e.g., Collegiate Enters., Inc. v. Otis Elevator Co.*, 650 F. Supp. 116, 118 (E.D. Mo. 1986) ("Under Missouri law, a plaintiff cannot recover damages for economic loss on a negligence theory."); *Wilbur Waggoner Equip. & Excavating Co. v. Clark Equip. Co.*, 668 S.W.2d 601, 603 (Mo. App. E.D. 1984) ("It is the law in Missouri, however, that recovery in tort for purely economic damage is limited to those cases where there is personal injury, damage to property other than that sold, or destruction of the property sold due to some violent occurrence.")

complexities involved in considering fault when allegations of negligence are intertwined with the contractual relationship between a professional and a client. This case perfectly illustrates the flaw in CWF's arguments.

Here, contributory negligence as a complete bar to recovery is both fair and equitable. CWF entered into a written agreement with MHM in which CWF agreed to make all financial records and related information available to MHM. (Tr. 497-500.) But CWF failed to make all its records available, and MHM could not have known at the time that CWF had omitted critical information. CWF received waybills that showed the number of pallets actually received but did not turn over these waybills to the team of auditors. (Ex. 1311, Bancroft testimony at 45-47; Tr. 375.) Had CWF fulfilled its contractual obligation to MHM to make all material financial records available, the auditors would not have had to rely on what turned out to be inaccurate confirmations by third parties. CWF thus breached its contract with MHM *during the audit*. This case is not about some minor error in CWF's records made before the audit began.

CWF asks the Court to abandon contributory negligence out of concern for "fundamental considerations of fairness." *See* Aplt. Subst. Br. at 33. In the context of a professional engagement such as this one, however, comparative fault risks an unfair result either to the client on the one hand, or to the auditor on the other. For example, if a client engages an accountant to perform an audit, it would be unfair to compare the client's negligence in keeping its records to the professional's negligence in auditing them, unless the client's negligence caused the problem with the professional's work. But in other circumstances, comparative fault may be unfair to the professional. Under

comparative fault principles, a professional might receive only a percentage reduction in damages when the professional should have been entitled to prevail because the duties undertaken never included preventing the economic loss suffered by the client. *See* Richard Scott Novak, *Attorney Malpractice: Restricting the Availability of the Client Contributory Negligence Defense*, 59 B.U. L. Rev. 950, 962-63 (1979).

3. No legal trend supports the abolition of contributory negligence in professional liability cases.

CWF cites a number of cases claiming they "illustrate a broad trend toward recognizing that comparative fault should apply in negligence cases that involve only economic damages." Aplt. Subst. Br. at 41; *see* cases cited Aplt. Subst. Br. at 36-41. To call these cases a "trend" is an overstatement. They analyze different issues and apply various types of comparative fault statutes. In *Gilchrist Timber Co. v. ITT Rayonier, Inc.*, 696 So.2d 334 (Fla. 1997), an action for negligent misrepresentation, the statute specifically included economic loss cases. It defined economic damages to include "any other economic loss which would not have occurred but for the injury giving rise to the cause of action" and also provided that it applied to "negligence cases," which it defined as including "professional malpractice whether couched in terms of contract or tort, or breach of warranty. . . ." *Id.* at 338. Similarly, in the Washington and Florida cases on which CWF relies, the courts applied comparative fault to negligent misrepresentation claims because the respective statutes required it. *See ESCA Corp. v. KPMG Peat Marwick*, 959 P.2d 651, 655-66 (Wash. 1998) (comparative fault principles apply to

negligent misrepresentation because the legislature intended to extend comparative fault principles "to all tort actions involving contributory fault"); *Shields v. Cape Fox Corp.*, 42 P.3d 1083, 1087-88 (Alaska 2002) ("Statute requires trial court to instruct on comparative fault in all cases involving the fault of one or more persons unless parties agree there shall be no such instruction.").

In five of the cases on which CWF relies the state's statute is the so-called modified comparative law in that it that retains the absolute bar to recovery if the plaintiff's fault exceeds that of the defendant. *See Robinson v. Poudre Valley Fed. Credit Union*, 654 P.2d 861, 863 (Colo. Ct. App. 1982); *Williams Ford, Inc. v. Hartford Courant Co.*, 657 A.2d 212, 225 (Conn. 1995); *Florenzano v. Olson*, 387 N.W.2d 168, 170, 176 (Minn. 1986); *H. Rosenblum, Inc. v. Adler*, 461 A.2d 138 (N.J. 1983) (superseded by statute); *Marchese v. Nelson*, 809 F. Supp. 880, 896 (D. Utah 1993). In the Arizona case cited by CWF, *Standard Chartered PLC v. Price Waterhouse*, 945 P.2d 317 (Ariz. Ct. App. 1997), the comparative fault statute had been amended subsequently to specifically include economic loss cases and the amendment advised that courts should not infer that the amendment implied one way or the other whether the statute before amendment included economic loss cases. *Id*. at 353. The Louisiana case cited by CWF refers to contributory fault and comparative fault interchangeably and the Mississippi case cited by CWF notes that it applies comparative fault even to fraud cases. *Pastor v. Lafayette Bldg. Assoc.*, 567 So.2d 793, 797 (La. Ct. App. 1990); *In re River Oaks Furniture, Inc.*, 276 B.R. 507, 546 (Bankr. N.D. Miss. 2001).

These cases present no evolution of law over time. Nor do they present a common theme. Most states have adopted comparative fault by statute, and case law is tied to the interpretation of the particular statute enacted in the given jurisdiction. Nor have most states adopted the pure comparative fault form endorsed by the UCFA and adopted by Missouri. *See* Victor E. Schwartz, *Comparative Negligence* 513-518 app. A (4th ed. 2002) (identifying 12 states and one territory that have adopted pure comparative negligence).

C. Instruction No. 11 Did Not Result In Prejudice. (Responds to § I E-F)

CWF claims that Instruction No. 11 warrants a new trial because (1) prejudice is presumed because MHM submitted the instruction; and (2) the instruction placed the burden on CWF to establish it was not negligent. Aplt. Subst. Br. at 45-46. Neither claim has merit.

Citing Court of Appeals decisions from 1991 or earlier, CWF argues that prejudice is presumed when the verdict is favorable to the parties who submitted the instruction. Aplt. Subst. Br. at 45. But more recently the Court of Appeals has shifted its position and demanded proof of actual prejudice. In *Dierker Associates, D.C., P.C. v. Gillis*, 859 S.W.2d 737, 744 (Mo. App. E.D. 1993), and again in *Incentive Realty, Inc. v. Hawatmeh*, 983 S.W.2d 156, 162 (Mo App. E.D. 1998), the Eastern District has stated, "We will not reverse for error in jury instructions unless prejudice is shown." CWF fails to identify a single case since *Dierker Associates* in which an appellate court has overturned a jury verdict where prejudice was "presumed" because the successful party submitted the

instruction at issue. And even if a presumption of prejudice arises, it can be rebutted. *See, e.g.*, *Citizens Bank*, 869 S.W.2d at 130 (concluding that a presumption of prejudice was "refuted by the record"); *Steenrod*, 789 S.W.2d at 164, 165, 171 (finding that a presumption of prejudice was rebutted because the plaintiff's claim failed as a matter of law). If prejudice is not presumed – as it should not be – CWF has failed to demonstrate any basis for it. In fact, as shown below, the evidence strongly established CWF's contributory negligence.

CWF's argues that Instruction No. 11 "had the effect of placing a burden upon CWF that should not have been imposed," because it heightened the standard of care. Aplt. Subst. Br. at 45. Yet CWF admits that the instruction "did not directly address CWF's standard of care." Aplt. Subst. Br. at 45-46. In fact, the jury was properly instructed on the respective standards of care of CWF and the defendants. *See* LF 59, 63 (Instructions 7, 11).[5] Moreover, the language of Instruction No. 11 tracks the instruction set forth by this Court in *Blackstock v. Kohn*, 994 S.W.2d 947, 952 n.2 (Mo. banc 1999), as an example of a contributory negligence instruction.

CWF cannot show prejudice for two reasons: (1) the evidence showed CWF caused its own injury; and (2) CWF never tendered an alternative or corrected instruction. First, CWF cannot show prejudice because the evidence demonstrated that CWF's misconduct caused the entirety of CWF's alleged injury. When reviewing a jury instruction courts "view the evidence most favorably to the instruction and disregard[s] contrary evidence." *Rinehart v. Shelter Gen. Ins. Co.*, 261 S.W.3d 583, 593 (Mo. App.

[5] A copy of these two instructions is included in the Appendix as well.

W.D. 2008). The evidence demonstrated that Stein and Dozoretz – in an attempt to shore up the organization's spiraling cost to raise a dollar – adopted a gift in kind strategy that they knew or should have known would lead to accounting problems, provided MHM (and ultimately the general public) with gift in kind information that they knew or should have known was false, and provided MHM with express assurances about this information that they knew or should have known were false. Among other things, the evidence demonstrated that:

- To deal with a change in accounting rules and to avoid having to report an even further increase in CWF's already high cost to raise a dollar – a ratio that put CWF in jeopardy with potential donors, watchdog organizations, and regulators – Stein and Dozoretz engineered a massive, tenfold increase in CWF's gifts in kind. (Tr. 243, 559; Ex. 38 at 9 ¶ 25.)
- The massive increase in-kind goods had been received and largely shipped out of the CWF warehouse before the auditors even arrived. (Tr. 749-50.)
- Despite receiving waybills and other information that showed the actual quantities of gifts in kind that had come in (Ex. 568; Tr. 563; Ex. 1311, Bancroft testimony at 45-47), Dozoretz never provided those waybills to MHM and instead furnished false information regarding inbound gifts in kind.
- As a result, the false information from CWF was later incorporated into CWF's financial statements. (*Compare* Ex. 85J at 1 (adjusted in-kind donations of $4,024,398) *with* Ex. 1282 at 12 (showing the same number in the financial statements, excluding wish items and automobiles).)

- Dozoretz also provided MHM with spreadsheets containing false information about outbound gifts in kind. This false information was later incorporated into the organization's tax return. (Tr. 224-25, 227-28, 232-33, 255-58, 259-60, 806; Ex. 113A; Ex. 113B.)

This is not a case of MHM failing to detect a garden-variety error caused by mere carelessness on the part of CWF. Instead, this is a case where CWF created the conditions that led to the error, failed to provide complete documentation and accurate information to be audited, and misrepresented the information that was given to MHM to review. MHM reasonably expanded its audit plan, tested the information provided by CWF as best it could in the absence of a complete record, and received a high level of assurance through third-party confirmation letters. (*Id.*) The evidence thus established that CWF was solely responsible for any gift in kind error in its financial statements or tax return, making Instruction 11 entirely proper.

Second, the lack of substantial prejudice is also shown by CWF's failure to tender an alternative instruction. A "failure to tender a corrected instruction" is a factor to be considered in determining prejudice. *Citizens Bank*, 869 S.W.2d at 129; *accord Gilbert v. K.T.I, Inc.*, 765 S.W.2d 289, 296 (Mo. App. W.D. 1988). CWF neither offered a substitute instruction for nor proposed a specific modification to Instruction 11. CWF's failure to do so speaks volumes about the immateriality of Instruction 11 in these circumstances, and undermines any inference of prejudice. *See, e.g., Gilbert*, 765 S.W.2d at 296 (finding no prejudice in part because the objecting party knew at the time of the

conference that the instruction in question was erroneous, but "did not assist in correcting the error").

CONCLUSION

For the foregoing reasons, the judgment in favor of MHM and CBIZ should be affirmed.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

It is hereby certified that this Brief includes the information required by Rule 55.03, and complies with the type-volume limitations set forth in Rule 84.06(b) in that the Brief contains 9,326 words excluding the cover, certificate of compliance, certificate of service, and signature block. In accordance with Rule 84.06(g), it is further certified that the enclosed CD has been scanned for viruses and is virus-free.

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CERTIFICATE OF SERVICE

It is hereby certified that on August 26, 2010 copies of Respondents' Substitute Brief, together with an accompanying CD, were sent by first class mail, postage pre-paid, to Michael Blanton, 11150 Overbrook Road, Ste. 350, Leawood, Kansas, 66211, counsel for Appellant Children's Wish Foundation International, Inc.

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