IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

DELOITTE LLP and DELOITTE & TOUCHE LLP, each a Delaware Limited Liability Partnership,	:	
Plaintiffs,	:	
v.	:	**C.A. No. 4125-VCN**
THOMAS P. FLANAGAN,	:	
Defendant.	:	

MEMORANDUM OPINION

Date Submitted: September 21, 2009
Date Decided: December 29, 2009

Paul J. Lockwood, Esquire of Skadden, Arps, Slate, Meagher & Flom LLP, Wilmington, Delaware, and Jay B. Kasner, Esquire and Joseph N. Sacca, Esquire of Skadden, Arps, Slate, Meagher & Flom LLP, New York, New York, Attorneys for Plaintiffs.

Philip A. Rovner, Esquire of Potter Anderson & Corroon LLP, Wilmington, Delaware, and J. Kevin McCall, Esquire, Chris C. Gair, Esquire, and Nicole A. Allen, Esquire of Jenner & Block LLP, Chicago, Illinois, Attorneys for Defendant.

NOBLE, Vice Chancellor

I. INTRODUCTION

A partner in an international accounting firm is accused by the partnership of trading in the securities of certain of the firm's clients, in contravention of his partnership agreement and of the general fiduciary duties he owed to his partners, and is further accused of fraudulently misrepresenting this trading activity in annual representations to the firm and within the firm's proprietary system designed to identify any such conflicts. The accounting firm has sued its now-former partner to recover for the damages he caused, or may be deemed to have caused, his firm. The accounting firm seeks partial summary judgment on the question of liability.

II. BACKGROUND

A. *The Parties*

Plaintiff Deloitte LLP is a Delaware limited liability partnership that, through its subsidiaries, provides audit, consulting, financial advisory, risk management, and tax services to a variety of clients throughout the United States. Plaintiff Deloitte & Touche LLP ("D&T" and, collectively with Deloitte LLP, "Deloitte" or the "Partnerships") is a Delaware limited liability partnership that provides audit and risk management services to clients throughout the United States.

Defendant Thomas P. Flanagan ("Flanagan"), a Certified Public Accountant, was a partner of one or both of the Partnerships or of a predecessor of Deloitte LLP for 30 years until his resignation on September 5, 2008. At the time of his resignation from Deloitte, Flanagan served as an advisory partner in Deloitte's Chicago office for a number of D&T's audit clients.

B. *Deloitte's Independence Policies*

All partners of Deloitte are obligated to sign a Memorandum of Agreement with each of the Partnerships (collectively, the "MOAs"), setting forth their rights and obligations as fiduciaries to the Partnerships. Among other obligations, the MOAs mandate that partners be just and faithful to the Partnerships and not engage in any conduct or activity inconsistent with the letter or spirit of Deloitte's rules regarding independence. These independence policies (the "Policies") are set forth in Deloitte's Independence and Ethics Manual and apply to the partners and to the professional and administrative employees of Deloitte.

The Policies have long prohibited partners and employees of Deloitte from owning any securities in the firm's "Attest Clients"[1] and, in order to facilitate compliance, the Partnerships provided a regularly-updated client list to all personnel, and directed Deloitte employees to review the list before making any

[1] The Independence Manual defines "Attest Clients" as clients for whom "attest services" such as audits, reviews of financial statements, or other "agreed-upon procedures or engagements," are performed. Affidavit of James Curry in Supp. of Pls.' Mot. for Partial Summ. J. ("Curry Aff."), Exs. 13-15 at § .021, Exs. 9-10 at § .030.

investments. The Policies also prohibit any and all insider trading, whether or not the non-public information was obtained by way of their employment.

To assist in monitoring compliance with the independence requirements, the Policies require partners and other professional personnel to enter current and accurate information concerning all investments held by them, their spouse or spousal equivalent, or their dependents into Deloitte's "Tracking & Trading System," which would flag and report any unauthorized holding. Finally, the Policies require partners and other professional personnel to provide an annual representation to the Partnerships that they had complied with the Policies (the "Annual Representation").

C. *Flanagan's Alleged Misconduct*

Flanagan consistently made Annual Representations to the Partnerships that, *inter alia*: (a) he was familiar with the Independence Manual and the Policies; (b) he had reviewed the list of Restricted Entities; (c) he had "accurately and completely describe[d] all stocks, debt securities, mutual funds, unit investment trusts, 529 plan accounts, and brokerage accounts held by [him], [his] spouse or spousal equivalent, and dependents"; (d) at no time during the relevant year "did [he], [his] spouse or spousal equivalent, and/or his dependents have a financial interest in a Restricted Entity"; and (e) he had not "serve[d] as the trustee of a trust

or as executor or administrator of an estate that had a financial interest in a Restricted Entity."[2]

The Complaint asserts that, notwithstanding such representations, Flanagan, in fact, traded in the shares of Deloitte clients in more than 300 instances over several years.[3] Almost none of these trades were recorded in the Tracking & Trading System. However, in 84 instances Flanagan recorded unauthorized holdings in the system but later that same day made an entry "correcting" the previous entry or indicating that he had disposed of the securities.[4] Such entries exploited the manner by which the system flagged unauthorized trading and thereby allowed Flanagan to escape review by Deloitte compliance personnel.[5] In many instances, the "correcting" entry reported in the Tracking & Trading system did not actually happen—Flanagan continued to hold the securities.[6]

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[2] Curry Aff., Exs. 17-23.

[3] The unauthorized trades occurred in accounts with Kovitz Investment Group, Inc. and Banc of American Investment Services, Inc. which Flanagan either owned or served as the trustee for, or that were owned by his wife or children. The accounts maintained at Kovitz Investment Group were "Thomas & Betsy Flanagan JTWROS," "Betsy P. Flanagan IRA R/O," "Betsy P. Flanagan Trust," "Thomas P. Flanagan Trust," "Thomas P. Flanagan IRA R/O," "Luke R. Pascale Irrevocable Trust," "Michael L. Flanagan IRA R/O," and "Brien Flanagan IRA R/O." The accounts held at Banc of America were "Thomas P. Flanagan/Betsy P. Flanagan" (the "Flanagan BOA Account"), "Mia Pascale/Thomas Flanagan" (the "Pascale/Flanagan Account"), "Luke R. Pascale Irrevocable Trust" (the "Pascale Trust Account-BOA"), and "NFS/FMTC Rollover IRA FBO Brien Flanagan."

[4] Def. Thomas B. Flanagan's Response in Opp'n to Pls.' Mot. for Partial S.J. ("Flanagan"), Ex. B ("Flanagan Exception Report").

[5] Flanagan, Ex. A ("Curry Deposition"), at 112-14.

[6] *Compare* Flanagan, Ex. B *with* Transmittal Affidavit of Paul J. Lockwood ("Lockwood Aff."), Ex. 20.

D. *Deloitte's Discovery of Flanagan's Wrongdoing*

Deloitte was unaware of any wrongdoing by Flanagan until August 2008, when it was contacted by the Securities and Exchange Commission (the "SEC") seeking the names and titles of all personnel who made up the engagement team for D&T audit client Walgreen Company between January and July 2007. Flanagan was the advisory partner for Walgreen Company and had contact with the company's top executives and audit committee. Walgreen had announced the acquisition of the company Option Care in July 2007. Flanagan allegedly purchased stock in Option Care roughly one week before Walgreen publicly announced the acquisition, but had not disclosed this trade to Deloitte. Later that month, the SEC again contacted Deloitte, asking which of a list of provided companies had D&T served as auditor and, further, for which of those audit clients had Flanagan served. Upon receiving these inquiries, Deloitte sought out Flanagan, who only then advised the Partnerships that he was aware of the regulatory investigation into his trading activity and that he had already spoken with SEC officials only to break off communication with them and to retain counsel. Shortly after these revelations, on September 9, 2008, Flanagan notified Deloitte that he was retiring, effective immediately.

In October 2008, in response to a request by Deloitte's attorney, Flanagan's then-counsel sent a letter confirming that, between at least December 2004 and

June 2008, Flanagan had engaged in, or directed or otherwise caused, a large number of trades in at least twenty Restricted Entities, including clients with which he had directly worked.[7]

E. *Claims Subject to Motion for Summary Judgment*

Deloitte requests partial summary judgment as to the question of liability on its claims for breach of fiduciary duty (Count I of the Amended Complaint), breach of contract (Count II), common law fraud (Count III) and equitable fraud (Count IV).

III. DISCUSSION

A. *The Summary Judgment Standard*

Court of Chancery Rule 56 allows for summary judgment when the record shows that "there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law."[8] The burden is initially on the moving party, and the Court views the evidence in the light most favorable to the nonmoving party.[9] The movant is required to present some evidence, either direct or circumstantial, to support all of the elements of the claims in question.[10] "However, once the moving party has satisfied its initial burden of 'demonstrating

[7] Curry Aff., Ex. 25. The Restricted Entities at issue include many well-known publicly traded companies. No useful purpose would be served by listing them here.
[8] Ct. Ch. R. 56(c).
[9] *In re Transkaryotic Therapies, Inc.*, 954 A.2d 346, 356 (Del. Ch. 2008).
[10] *Watson v. Taylor*, 829 A.2d 936 (TABLE), 2003 WL 21810822, at *2 (Del. Aug. 4, 2003).

the absence of a material factual dispute,' the burden shifts to the nonmovant to present some specific, admissible evidence that there is a genuine issue of fact for a trial."[11] Where both sides put forth conflicting evidence such that there is an issue of material fact, summary judgment must be denied.[12] A fact is material if it "might affect the outcome of the suit under the governing law."[13] There is a genuine issue of material fact "if the evidence is such that a reasonable jury could return a verdict for the nonmoving party."[14] It is not enough that the nonmoving party put forward a mere scintilla of evidence; there must be enough evidence that a rational finder of fact could find some material fact that would favor the non-moving party in a determinative way, drawing all inferences in favor of the nonmoving party.[15]

In addition, Chancery Court Rule 56(c) provides that summary judgment "may be rendered on the issues of liability alone although there is a genuine issue as to the amount of damages, or some other matter."[16] Consequently, Delaware courts have, with some regularity, granted motions for partial summary judgment as to liability while leaving questions of damages or remedy for trial.[17]

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[11] *Id.* (quoting *Levy v. HLI Operating Co., Inc.*, 924 A.2d 210, 219 (Del. Ch. 2007)).
[12] *Id.*
[13] *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986).
[14] *Id.*
[15] *Cerberus Int'l, Ltd. v. Apollo Mgmt., L.P.*, 794 A.2d 1141, 1150 (Del. 2002).
[16] Ct. Ch. R. 56(c).
[17] *See, e.g.*, *Those Certain Underwriters at Lloyd's, London v. Nat'l Installment Ins. Servs., Inc.*, 2007 WL 1207106, at *6 (Del. Ch. Feb. 8, 2007, *rev.* Apr. 16, 2007); *Merritt v. Colonial Foods,*

B. *The Scope of Activity Considered*

Flanagan has raised certain defenses for a number of his trades. He has asserted that all questionable trades made before October 29, 2005, are barred by the three-year statute of limitations for breach of contract, breach of fiduciary duty, and fraud claims, as well as by the doctrine of laches.[18] In addition, Flanagan claims that he is not liable for any trades made in accounts maintained at Kovitz Investment Group, LLC, because these accounts were discretionary and Flanagan did not personally direct trading in them. Flanagan also contends that certain of his trades were permitted under SEC and American Institute of Certified Public Accountants ("AICPA") rules—specifically, the trading of securities of clients that he did not serve and that were not clients of the Chicago office—and that Deloitte's Independence Manual is unclear and subject to various interpretations, including that adhering to SEC and AICPA rules sufficed for purposes of the MOAs. Finally, Flanagan argues that a disputed issue of material fact exists regarding how clearly Deloitte communicated to its partners and employees which entities were, in fact, Restricted Entities, and that Deloitte has failed to prove

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Inc., 505 A.2d 757, 759 (Del. Ch. 1986); *Pfizer Inc. v. Advance Monobloc Corp.*, 1999 WL 743927, at *16 (Del. Super. Sept. 2, 1999).

[18] Flanagan asserts that Deloitte was put on inquiry notice regarding violations of the MOAs after he reported holding Restricted Entities in the Tracking & Trading system, and its failure to investigate his questionable trades prevents the statute of limitations from being tolled, thus barring any claims based upon pre-October 2005 conduct.

which entities were restricted, when they were restricted, and that Flanagan was informed that they were restricted.

This Court does not presume to evaluate each and every one of Flanagan's suspect trades. Indeed, a single instance of intentional trading in a Restricted Entity and a knowing misrepresentation of the same would seemingly be sufficient to establish not only a breach of both the MOAs and the fiduciary duties owed to Deloitte, but also the principal elements of common law fraud and equitable fraud. The question of which of the contested trades, if any, ought to be ignored due to Flanagan's divers defenses, listed above, may bear on the ultimate question of damages, but it is not necessary for this Court to address these defenses within the context of this motion for partial summary judgment unless, *in toto*, the defenses would serve to undermine at least one essential factual predicate for each of Deloitte's claims. A review of the record indicates that they do not. Consequently, and for simplicity's sake, this Court will focus only on a subset of trades for which Flanagan has not proffered a defense and which appear most obviously in violation of Deloitte's Independence Policies.[19]

[19] In so doing, the Court cites to some certain arguably unauthenticated documents, such as emails and board minutes, which Flanagan asserts should not be considered. The Court only draws from these documents to provide context, and not to establish any essential element of Deloitte's claims. The critical element, that these were all Restricted Entities at the time, was admitted by Flanagan's then-counsel in an October 22, 2008, letter to Deloitte's counsel. *See* Curry Aff., ¶¶ 38-39; Ex. 25.

1. Trading in Allstate Corporation

On July 17, 2006, Flanagan attended a meeting of the audit committee for Allstate Corporation ("Allstate"), a Deloitte client for which he provided audit services. During the meeting, a draft of Allstate's earning release for the quarter ending June 30, 2006, was circulated.[20] The following day, Flanagan purchased call options in Allstate shares through the Pascale Trust Account-BOA, for which he was trustee.[21] On July 19, Allstate publicly issued its earnings release, announcing a significant increase in its full-year EPS guidance, causing a spike in share price.[22] Flanagan sold the Allstate call options on July 20 for roughly an 85% gain.[23]

2. Trading in Best Buy Co., Inc.

Deloitte also asserts that a series of trades made by Flanagan over the course of a few years in Best Buy Co., Inc. ("Best Buy"), a company for which he directly provided audit services, also establishes his liability.

On December 9, 2005, at 12:34 a.m., Flanagan received an email attaching a draft of Best Buy's third quarter earnings release.[24] The draft indicated that Best Buy was going to announce earnings below market expectations.[25] Later that same

[20] Lockwood Aff., Ex. 32.
[21] *Id.*, Ex. 33.
[22] *Id.*, Ex. 34, at 1.
[23] *Id.*, Ex. 33.
[24] *Id.*, Exs. 35-37.
[25] *Id.*, Ex. 36.

day, Flanagan purchased put options in Best Buy through the Pascale/Flanagan account.[26] On December 13, 2005, Best Buy's earnings release was made public.[27] On December 14, Flanagan sold these put options for a return of approximately 67%.[28]

A year later, on December 9, 2006, Flanagan again received an email attaching a draft of Best Buy's upcoming earnings release, which similarly indicated that Best Buy would release earnings figures below the consensus estimate of market analysts.[29] On December 11, Flanagan purchased Best Buy put options through the Pascale Trust Account-BOA.[30] The following day, Best Buy released its earnings announcement, resulting in a share price decline.[31] On December 13, Flanagan sold his put options for another 67% return.[32]

On June 15, 2007, Flanagan received yet another draft earnings release indicating that Best Buy would miss earnings estimates.[33] On June 18, Flanagan purchased put options through the Pascale Trust Account-BOA and the Flanagan BOA Account.[34] The following day, the earnings release was made public.[35]

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[26] *Id.*, Ex. 38.
[27] *Id.*, Ex. 39.
[28] *Id.*, Ex. 38.
[29] *Id.*, Exs. 40-41.
[30] *Id.*, Ex. 42.
[31] *Id.*, Ex. 43.
[32] *Id.*, Ex. 42.
[33] *Id.*, Exs. 44-46.
[34] *Id.*, Exs. 47-48.
[35] *Id.*, Ex. 49.

From June 19 through June 21, Flanagan sold his put options for returns between 32% and 42%.[36]

On September 12, 2007, Flanagan attended a Best Buy audit committee meeting held in advance of the company's quarterly earnings release.[37] Later that day, Flanagan purchased Best Buy call options through the Pascale Trust Account-BOA.[38] On September 18, the company released earnings above consensus market estimates.[39] That same day, Flanagan sold the call options for a 95% return.[40]

On February 13, 2008, Flanagan received an email from Best Buy regarding its fiscal year 2008 guidance and attaching a draft press release that stated that the company was lowering its earnings guidance based upon lower-than-expected revenue growth.[41] On the same day, Flanagan purchased put options through the Pascale Trust Account-BOA and the Flanagan BOA Account.[42] The company released the revised earnings guidance on February 15, 2008.[43] Flanagan sold the put options on March 5, 2008 for 36% return.[44]

On March 28, 2008, Flanagan received an email from Best Buy that attached the company's upcoming earnings release, showing that earnings would be higher

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[36] *Id.*, Exs. 47-48.
[37] *Id.*, Ex. 50, at 1.
[38] *Id.*, Exs. 51-52.
[39] *Id.*, Ex. 53.
[40] *Id.*, Exs. 51-52.
[41] *Id.*, Exs. 54-55.
[42] *Id.*, Exs. 56-57.
[43] *Id.*, Ex. 58.
[44] *Id.*, Exs. 56-57.

than market estimates.[45] On April 1, 2008, Flanagan purchased call options through the Pascale Trust Account-BOA. The following day, Best Buy released its earnings and Flanagan sold his call options, making a 31% return.[46]

3. Trading in Motorola Corporation

Flanagan is also alleged to have improperly traded in options of Motorola Corporation ("Motorola"), another of Deloitte's clients. On January 4, 2008, Flanagan received an email from a Deloitte partner in Boston informing him that Motorola's CEO had stated in a private meeting that the company's performance "will be significantly worse than anybody's imagined" and that a huge, across-the-board, cost reduction was in the works.[47] On January 14, Flanagan purchased Motorola put options through the Flanagan BOA account.[48] The following week, Motorola issued its earnings release, causing shares to plummet.[49] Flanagan sold his put options on the day of the announcement for a 1,400% return.[50]

C. *The Breach of Contract Claim*

Summary judgment is frequently appropriate for breach of contract claims because, under Delaware law, the interpretation of a contract is a question of law.[51] As part of that review, the court strives to determine the parties' shared intent,

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[45] *Id.*, Exs. 59-60.
[46] *Id.*, Exs. 61-62.
[47] *Id.*, Ex. 63.
[48] *Id.*, Ex. 64.
[49] *Id.*, Ex. 65.
[50] *Id.*, Ex. 64.
[51] *Schuss v. Penfield Partners, L.P.*, 2008 WL 2433842, at *6 (Del. Ch. June 13, 2008).

interpreting the contractual language "using their common or ordinary meaning, unless the contract clearly shows that the parties' intent was otherwise."[52] If the contractual language is plain and unambiguous, the Court should give binding effect to its ordinary and usual meaning.[53] Nevertheless, there remains, of course, the question of whether any material facts regarding the conduct of the contracting parties are in dispute.

1. The Memoranda of Agreement[54]

Article 9 of the MOAs requires partners to "be just and faithful to the Partnership . . . in all actions and in respect of the business and reputation of the Partnership,"[55] and obligates them not to "engage in any conduct or activity . . . contrary or inconsistent with the letter or spirit of the rules relating to independence and conflicts of interest."[56] In addition, partners must "submit to the Partnership . . . as requested a written report . . . setting forth such information as

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[52] *Cove on Herring Creek Homeowners' Ass'n v. Riggs*, 2005 WL 1252399, at *1 (Del. Ch. May 19, 2005) (quoting *Paxon Commc'ns Corp. v. NBC Universal, Inc.*, 2005 WL 1038997, at *9 (Del. Ch. Apr. 29, 2005)).

[53] *Rhone-Poulec Basic Chems. Co. v. Amer. Motorists Ins. Co.*, 616 A.2d 1192, 1195 (Del. 1992). Ambiguity does not necessarily exist simply because the parties disagree on a contract's proper construction. *United Rentals, Inc. v. Ram Holdings, Inc.*, 2007 WL 4496338, at *15 (Del. Ch. Dec. 21, 2007).

[54] The MOAs are governed by, and are to be construed in accordance with, Delaware law. Curry Aff., Exs. 2, 6, 8 (the "Deloitte LLP MOAs"), at § 14.02; Exs. 3, 7 (the "D&T MOAs"), at § 13.02.

[55] Curry Aff., Exs. 2-3, 6-8, at § 9.02.

[56] Curry Aff., Exs. 2-3, 6-8, at § 9.021.

the Board may deem appropriate to ascertain compliance . . . with the rules relating to independence, outside activities and conflicts of interest. . . ."[57]

2. The Independence Policies

The Policies state that partners and other employees of Deloitte are "prohibited from having a direct Financial Interest or material Indirect Financial Interest in a Restricted Entity."[58] The Policies define "Financial Interest" broadly, encompassing, *inter alia*, "the ownership or guarantee of debt or equity securities, options, warrants, long or short security positions, and rights or other commitments to acquire such securities."[59] The Policies also give broad definition to the term "Restricted Entity," including within its scope all of D&T's audit clients, as well as any affiliates of these clients.[60]

The Policies additionally bar employees from trading in the securities of or relating to companies about which they possess material non-public information, and require employees to notify Deloitte of any circumstances in which they had a prior notice of a transaction by a client that might affect their personal interests, such as a Financial Interest held by the employee in a client's proposed acquisition

[57] Curry Aff., Exs. 2-3, 6-8, at § 9.023.
[58] Curry Aff., Exs. 9-12, at ¶ .201.
[59] Curry Aff., Exs. 9-12, at ¶ .030. This extends to any securities held by a spouse or dependent, as well. *Id.* at ¶ .038.
[60] *Id.* at ¶ .040.

target.[61] The Policies also warn of the appearance of impropriety, noting that "[i]n view of the sensitivity that often accompanies allegations of use of insider information, all personnel should avoid circumstances that might cause embarrassment to the Firm."[62]

The Policies unambiguously prohibit any trades in Restricted Entities, and the MOAs mandate adherence to both the "spirit and letter" of the Policies. Deloitte asserts that, between 2001 and 2008, Flanagan made investments in Restricted Entities more than 300 times. Flanagan has raised a number of defenses and possible material factual disputes with respect to a number of these trades, listed above. However, as the Policies do not provide a *de minimis* exception for trading in Restricted Entities, this Court need only find that there is no issue of genuine fact with respect to a single trade in a Restricted Entity in order to find that Flanagan breached Article 9 of the MOAs.

Flanagan has not offered a defense for the trades in Allstate, Best Buy, and Motorola, discussed above. Whether or not Deloitte maintained an updated Restricted Entities list or whether or not the Policies were clear as to which types of entities ought to be considered Restricted Entities, Flanagan was on actual notice that these three entities were clients of Deloitte, because he personally

[61] *Id.* at ¶¶ .234-.235. In such an instance, the Policies state that "[a]ppropriate steps should be taken to ensure that the individual does not provide any professional services to the client and the Member should divest of the Financial Interest as soon as practicable." *Id.* at ¶ .235.
[62] *Id.* at ¶ .235.

provided them audit services[63] or previously acknowledged their status as Restricted Entities.[64] Consequently, Flanagan's trading in these entities, and his failure to properly report his trades either in Deloitte's Tracking & Trading System or in his Annual Representations, constituted a breach of Article 9 of the MOAs.

D. *The Breach of Fiduciary Duty Claim*

Deloitte asserts that Flanagan has breached the fiduciary duties of good faith and loyalty he owed to the Partnerships under "common law, the Delaware Revised Uniform Partnership Act, and the MOAs" by "willfully violating his obligations to honor Deloitte's policies on independence and conflicts of interest," and by concealing this wrongful conduct through intentional misrepresentations to Deloitte.[65] These breaches, Deloitte contends, "resulted in substantial damage to the Partnerships," including the payment of compensation to Flanagan that Deloitte contends he waived the right to receive by virtue of his conduct.[66]

The MOAs countenance an express fiduciary obligation of partners to the Partnerships, stating that "[e]ach active party shall be just and faithful to the Partnership . . . in all actions and in respect of the business and reputations of the Partnership."[67] Flanagan's conduct here—in particular, his misrepresentations

[63] Flanagan, Ex. A, at 187-88, 224.
[64] In his 2002 Annual Representation, Flanagan disclosed that he had owned and sold interests in two Restricted Entities, one of which was Motorola. Curry Aff., Ex. 12.
[65] Am. Compl. ¶¶ 69-70.
[66] Am. Compl. ¶ 71.
[67] Curry Aff., Exs. 2-3, 6-8, at § 9.02.

with respect to his holdings—suffices to constitute a breach of his duty to be "just and faithful to the Partnership." Thus, Deloitte's motion for summary judgment on its breach of fiduciary duty claim is granted.[68]

E. *The Equitable Fraud Claim*

Deloitte also brings a claim against Flanagan for equitable fraud, or negligent misrepresentation. To prevail on an equitable fraud claim, Deloitte must establish: (1) that Flanagan had a pecuniary duty to provide accurate information; (2) that Flanagan supplied false information; (3) that Flanagan failed to exercise reasonable care in obtaining or communicating the information; and (4) that Deloitte suffered a pecuniary loss in reliance upon the false information.[69] In addition to overt misrepresentations, fraud can also "occur through deliberate concealment of material facts, or by silence in the face of a duty to speak."[70]

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[68] The Court need not determine the more interesting doctrinal question of whether Deloitte's breach of fiduciary duty claim, arising out of the same set of operative facts as its breach of contract claim, ought to be dismissed as duplicative of the contract claim, or whether the existence of any preexisting equitable duties or the language of the MOAs would preclude such a dismissal. *Compare, e.g.*, *Solow v. Aspect Resources, LLC*, 2004 WL 2694916, at *4 (Del. Ch. Oct. 19, 2004) *with R.J. Assoc., Inc. v. Health Payor's Org. Ltd. P'ship*, 1999 WL 550350, at *10 (Del. Ch. July 16, 1999); *Cantor Fitzgerald, L.P. v. Cantor*, 724 A.2d 571, 582 (Del. Ch. 1998). Flanagan has not raised this question, and it is not likely to have an effect on any eventual damages award because an adequate remedy for Deloitte's breach of contract claim would seemingly subsume any entitlements Deloitte may have under its breach of fiduciary duty claim.

[69] *Steinman v. Levine*, 2002 WL 31761252, at *15 (Del. Ch. Nov. 27, 2002).

[70] *Kronenberg v. Katz*, 872 A.2d 568, 585 n.25 (Del. Ch. 2004) (quoting *H-M Wexford LLC v. Encorp, Inc.*, 832 A.2d 129, 144-45 (Del. Ch. 2003)).

The MOAs and the Policies facially establish that Flanagan had an obligation to accurately complete the Annual Representations and to maintain a complete and accurate record of his holdings in Deloitte's Tracking & Trading system at all times.[71] Flanagan has conceded that his Annual Representations, wherein he asserted that "[a]t no time during the Period did I, my spouse or spousal equivalent, and/or my dependents have a financial interest in a Restricted Entity for which I was a Member that was not permissible per the *Independence Manual*," were not accurate,[72] and that he failed to enter numerous unauthorized trades in the Tracking & Trading System[73] or else inputted and subsequently removed trades in the system before warnings to Deloitte compliance personnel were triggered, even where he continued to hold the securities in question.[74] Flanagan suggests that there is no evidence that he, himself, used the Tracking & Trading System, and that any failure to correctly input his trades was likely an error by his secretary.[75]

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[71] Section 9.023 of the MOAs establishes the obligation to "submit to the Partnership at least annually as requested a written report signed by [Flanagan] setting forth such information as the Board may deem appropriate to ascertain compliance by [Flanagan] with the rules relating to independence, outside activities and conflicts of interest. . . ." The Policies state that "[a]ll Professional Personnel are required to provide a written statement that they (1) have read the Firm's independence and ethics policies, (2) understand their applicability, including the applicability to immediate family members and Close Relatives, and (3) have complied with such policies." Curry Aff., Exs. 9-12, at .P06. Additionally, "[a]ll Partners . . . are responsible for ensuring that the Deloitte Tracking & Trading system . . . has current and accurate information concerning investments. . . ." Curry Aff., Exs. 9-12, at .P08.

[72] *Compare* Curry Aff., Ex. 25 *with* Curry Aff., Exs. 17-24.

[73] *Compare* Curry Aff., Ex. 25 *with* Flanagan, Ex. B.

[74] Flanagan, Ex. B.

[75] Flanagan at 21.

Nevertheless, as Flanagan was personally responsible for the accuracy of the information and directly attested to its truthfulness, the Court must still conclude that Flanagan supplied false information and, at the very least, failed to exercise reasonable care in obtaining or communicating this information to Deloitte.[76]

Flanagan asserts that Deloitte has not put forward any evidence regarding the Partnerships' reliance on his misrepresentations: therefore, a disputed issue of material fact exists with respect to this element. The Policies, however, state that "[i]t is fundamental to our professional practice and ethics that each of us strives to adhere to the highest standards of independence, integrity, and objectivity and to be free from conflicts of interest."[77] This statement simply codifies what would seem to be a truism about the accounting profession: that because an auditor sells, at base, its independence and integrity, the firm relies heavily on the purported honesty and independence of its professionals.[78] Indeed, "[a]n accountant's

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[76] This is despite the fact that the sheer number of unreported trades in Restricted Entities (hundreds over the course of eight years) makes Flanagan's explanation of data entry errors by his secretary a rather implausible one.

[77] Curry Aff., Exs. 9-12, at 1.

[78] The AICPA Statement on Auditing Standards No. 1, Codification of Auditing Standards and Procedures (SAS No. 1) states that "[i]t is of utmost importance to the profession that the general public maintain confidence in the independence of independent auditors. Public confidence would be impaired by evidence that independence was actually lacking, and it might also be impaired by the existence of circumstances which reasonable people might believe likely to influence independence. . . . Independent auditors should not only be independent in fact; they should avoid situations that may lead outsiders to doubt their independence." AICPA SAS No. 1, AU § 220.03. *See also U.S. v. Arthur Young & Co.*, 465 U.S. 805, 817-18 (1984) ("By certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a *public* responsibility transcending any employment relationship with the client. The independent public accountant performing this special function owes

greatest asset is its reputation for honesty, followed closely by its reputation for careful work."[79] Thus, there is no issue of material fact with respect to Deloitte's reliance on Flanagan's misstatements.

As there are no issues of material fact relating to any of the necessary elements of Deloitte's equitable fraud claim, summary judgment on this claim is granted.

F. *The Common Law Fraud Claim*

In contrast to equitable fraud claims, common law fraud requires that the plaintiff establish scienter, that the defendant committed the misstatement recklessly or with intent. Flanagan asserts that Deloitte has not met its burden of proving intent, in part because it has not offered any evidence establishing custody for the emails and board minutes that it uses to establish that Flanagan had access to material non-public information.

Scienter is "'a mental state embracing intent to deceive, manipulate or defraud.'"[80] A plaintiff may establish scienter by demonstrating either a "deliberate or reckless misrepresentation of a material fact" by defendants.[81] A

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ultimate allegiance to the corporation's creditors and stockholders, as well as to investing public. This 'public watchdog' function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust.").

[79] *DiLeo v. Ernst & Young*, 901 F.2d 624, 629 (7th Cir. 1990).

[80] *Dirks v. SEC*, 463 U.S. 646, 663 n.23 (1983) (quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193-94 n.12 (1976)).

[81] *Newton v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 135 F.3d 266, 273 (3d Cir. 1998).

reckless statement is one "involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care. . . ."[82] Thus, to succeed on a motion for summary judgment, Deloitte must show that a jury could not reasonably find that Flanagan's misstatements were not an extreme departure from the standards of ordinary care.[83]

To prove scienter, a plaintiff "need not produce direct evidence of the defendant's state of mind."[84] "Circumstantial evidence may often be the principal, if not the only, means of proving bad faith."[85] The Third Circuit has endorsed a variant of the totality of circumstances approach in establishing scienter for securities fraud cases presenting highly suspicious circumstances.[86] Plaintiffs can establish scienter with facts "establishing a motive and an opportunity to commit fraud, or by setting forth facts that constitute circumstantial evidence of either reckless or conscious behavior"[87] where they are plead with particularity and give rise to a "strong inference" of scienter.[88]

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[82] *In re Digital Island Sec. Litig.*, 357 F.3d 322, 332 (3d Cir. 2004) (quoting *In re Advanta Corp. Sec. Litig.*, 180 F.3d 525, 535 (3d Cir. 1999)).
[83] *See In re Phillips Petroleum Sec. Litig.*, 881 F.2d 1236, 1247 (3d Cir. 1989).
[84] *McLean v. Alexander*, 599 F.2d 1190, 1198 (3d Cir.1979).
[85] *Id.*
[86] *See, e.g.*, *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1424 (3d Cir. 1997) ("We will not infer fraudulent intent from the mere fact that some officers sold stock. . . . Instead, plaintiffs must allege that the trades were made at times and in quantities that were suspicious enough to support the necessary strong inference of scienter.").
[87] *Weiner v. Quaker Oats Co.*, 129 F.3d 310, 318 n.8 (3d Cir. 1997).
[88] *Advanta*, 180 F.3d at 534-35. *But see Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007) (suggesting that scienter cannot be inferred solely on the basis of motive and

The evidence presented here—specifically, the magnitude of unauthorized trades, the incredibly prescient trading in those clients for which Flanagan had material nonpublic information, along with his misuse of the Tracking & Trading system—leaves only one reasonable inference, that of scienter. Instead of presenting facts that would undercut this inference or offer innocent explanations for his conduct, Flanagan has chosen to exercise his Fifth Amendment right against self-incrimination.[89] Absent countervailing facts, it cannot be said that a material issue of fact remains with respect to Flanagan's scienter.[90] Consequently, Deloitte's motion for summary judgment on liability with respect to the fraud claim is also granted.[91]

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opportunity). Among other things, "if . . . stock sales were unusual in scope or timing, they may support an inference of scienter." *Advanta*, 180 F.3d at 540.

[89] In his deposition, Flanagan invoked the privilege against self-incrimination more than 800 times in response to attorney questioning. Lockwood Aff., Ex. 2 ("Flanagan Dep."), *passim*.

[90] *Cf. SEC v. Lyttle*, 538 F.3d 601, 604 (7th Cir. 2008) ("[T]he consequence of [the defendants'] refusal [to testify on Fifth Amendment grounds] is that they cannot testify to their state of mind. Without such testimony to contradict the mountain of circumstantial evidence (circumstantial with regard to the defendants' inmost beliefs, at any rate) that the SEC presented, evidence reinforced by the inference (permissible in a civil case) of guilt from their refusal to testify, no reasonable jury could doubt that they had acted with scienter. . . .") (internal citation omitted).

[91] Deloitte has additionally argued that Flanagan is guilty of violating the federal securities laws and that it is entitled to partial summary judgment as to liability upon such a finding. However, the Court need not consider whether Flanagan's behavior constituted a violation of federal securities laws in order to grant Deloitte's motion for partial summary judgment and has refrained from doing so here. The Court concludes that such a determination is perhaps better left to others.

IV. CONCLUSION

For the aforementioned reasons, Plaintiffs' motion for partial summary judgment as to liability is granted. An implementing order will be entered.