

Peat Faces Orange County \$3 Billion Suit

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Orange County, Calif., plans to sue its former outside auditor, KPMG Peat Marwick, for as much as \$3 billion, claiming the accounting firm failed to warn about the county's high-risk investment fund, according to several people familiar with the situation.

The county, still reeling from the fund's collapse last December with \$1.7 billion in losses, intends to file the suit sometime in the next few weeks, these people said. "There's no doubt that they are the next big target" for litigation, one senior county adviser said.

Orange County already has filed a \$3 billion lawsuit against Merrill Lynch & Co., accusing the brokerage firm of promoting a highly risky investment strategy that led to the investment fund's collapse. Although both sides began preliminary talks in May about a possible settlement, those talks have now been suspended. The slow progress of the Merrill litigation is one reason why Orange County has now decided to go after Peat Marwick, people familiar with the situation said.

Orange County, struggling to put together a financial-rescue package, is under pressure to raise funds to repay about \$700 million to the county's cities and agencies that incurred losses in the investment pool. The county also has to find a way to repay some of the \$800 million owed to bondholders and other creditors. Orange County and the investment pool have been operating under bankruptcy-court protection against creditors since the fund collapsed in December.

Accounting Firm Prepares

County officials declined to comment, but Peat Marwick has already alerted its outside counsel and top management to expect a suit. Officials at the nation's fourth-biggest accounting firm said the litigation would be a blow to the firm, regardless of the outcome.

"Any Orange County legal action against us will be abusive, costing us a lot to defend, and will give us a negative image in the marketplace," said John R. Miller, Peat's national director of governmental services based in New York. Even so, he denied any wrongdoing by the firm, saying "there is no evidence that Peat had any role in the county's problems with its investments."

The expected suit would come at a bad time for Peat. The accounting firm is just emerging from four years of fairly flat revenues and has been working hard to shed risky audit clients. Peat also has been beset by internal restructuring and morale problems following an extensive revamping of its business into industry lines rather than the traditional audit, tax and consulting areas.

Arthur Bowman, editor of Bowman's Accounting Report, a monthly newsletter on the accounting business, said: "Any suit by Orange County against Peat would be a black eye against the firm." And it could hurt the overall campaign of Peat and the other Big Six accounting firms to win congressional approval for a tort-reform bill that would make it harder to file negligence suits against accounting firms and other professionals.

As the outside auditor, Peat Marwick was responsible for making sure the county's financial statements conformed with generally accepted accounting principles. Mr. Miller said the county's financial problems were "based on things that were outside our control and were unrelated to our performance."

He cited a recent report by a California legislative study group that didn't blame Peat. The study did blame Robert Citron, the former county treasurer, lax oversight on the part of other county officials and alleged lapses by major debt-rating services, various securities firms and underwriters. Mr. Citron, who resigned shortly before the investment pool collapsed, pleaded guilty in April to six felony charges of misleading investors and misrepresenting interest earnings.

Package Cobbled Together

Against the backdrop of further litigation, Orange County and representatives of municipalities, school districts and the local transportation agency have cobbled together a proposed plan designed to partially plug their budget shortfalls.

The package, which has won the guarded endorsement of lawmakers as well as Gov. Pete Wilson, calls for raising about \$800 million over 20 years by diverting certain tax revenue now flowing to the Orange County Transportation Authority, flood-control districts and other agencies. Under the plan, repayment of another \$700 million to cities and various agencies depends on the county's success in litigation against Merrill and other parties.