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Accountant's Liability to Third Parties for Negligence

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It is suggested that this result could have been obtained by a decision of less sweeping impact than the one rendered. The case could have been limited to its facts by holding that a provision for setting off medical payments against uninsured motorist coverage contravenes public policy and will not be given effect *where the lessened coverage is not reflected in an appropriately reduced premium.* When there is a reduction in the premium, the aggregate coverage would certainly be more than that prescribed by the statute, and the cost of that portion of the coverage making up the statutory minimum requirement would presumably not be different from the cost of buying uninsured motorist coverage at a higher premium without medical payment coverage. The fact that the required coverage would, in that case, be supplied under two different endorsements is of no practical significance; the insured is provided with the statutory protection as certainly as if he had bought only uninsured motorist coverage.

Under the *Tuggle* rule, the insured cannot avoid paying an uninsured motorist premium that contemplates a double recovery, even if he does not secure that windfall to himself by buying medical payments coverage. The insurer, on the other hand, can only defend himself against the depredations of an unscrupulous accident victim by shouldering the difficult burden of showing that the expenses incurred were not reasonably necessary. The *Tuggle* decision seems to motivate the insured to unconscionable conduct by forcing him to contract for more than indemnification at a higher premium.

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ACCOUNTANT'S LIABILITY TO THIRD PARTIES FOR NEGLIGENCE

The plaintiff had a contract to purchase a large block of stock in the Belcher-Young Corporation with an option to rescind if a certified financial statement revealed that the financial condition of the corporation had changed adversely since the last statement shown to the plaintiff. The defendants, certified public accountants, were engaged by Belcher to conduct the audit and to prepare the financial statements knowing that the plaintiff intended to rely on their certification. The defendants were negligent in the preparation of the financial statements, and the corporation subse-

would be afforded had the insured thereunder been involved in an accident with a motorist who is insured under a policy of liability insurance with the minimum limits provided under § 324.021(7). Such forms of coverage may include such reasonable terms and conditions, including offsets which are designed to avoid duplication of insurance and other benefits, as are commensurate with and reflected in the premium charged therefor. The insurance commissioner shall give due consideration to the coverage afforded in determining whether the premium therefor meets the requirements of Part I of Chapter 627 of the code.

Cf. Fuller, R.S., *A Practical Approach to Florida's Uninsured Motorist Coverage.* LL.M THESIS, University of Miami, 1968.

quently failed. The plaintiff, who had relied on the defendants' certification in electing not to rescind the contract and who received nothing for its stock, sued in three counts, alleging fraud on the part of defendants, a third party beneficiary contract between defendants and Belcher, and breach of the duty of care owed by defendants to known third parties. The jury found for the defendants on the counts alleging fraud and a third party beneficiary contract, and the count alleging negligence was dismissed. On appeal to the District Court of Appeal, Second District, *held*, affirmed: Accountants are not liable to a known third party for negligence in the preparation of certified financial statements, even though they know that the third party intends to rely on them. *Investment Corporation of Florida v. Buchman*, 208 So.2d 291 (Fla. 2d Dist. 1968).

The law governing the duty owed by accountants to parties with whom they are not in privity grew out of the action of deceit. This is because words, rather than a physical force producing bodily injury or property damage, are the force which produces an economic loss. Deceit was long ago established to be an intentional tort, and the case of *Derry v. Peek*[1] has been understood to stand for the proposition that there is no liability for negligent misrepresentations to those not in privity of contract.[2]

The leading case in the United States involving the liability of accountants for their certified statements is *Ultramares Corporation v. Touche*[3] in which Mr. Justice Cardozo rejected negligence as a basis for liability to persons not in privity of contract. Previously in *Glanzer v. Shepard*[4] Cardozo had held a public weigher of beans liable to a purchaser who relied on his negligent report, on the theory that the report was the "end and aim of the transaction" between the seller and the defendant. The refusal to allow recovery for negligence in *Ultramares* was due to a fear of casting tremendous potential liability upon the accounting profession[5] and a desire not to abolish the *scienter* requirement in actions involving false representations. This fear of casting disproportionate liability upon other professions has led the majority of courts to adopt the *Ultramares* reasoning by denying recovery for negligence to those not in privity.[6] Recovery was allowed in *Ultramares* for fraud in certifying a fact

1. [1889] 14 A.C. 337.

2. National Savings Bank v. Ward, 100 U.S. 195 (1879); Landell v. Lybrand, 264 Pa. 406, 107 A. 783 (1919); Le Lievre v. Gould, [1893] 1 Q.B. 491.

3. 255 N.Y. 170, 174 N.E. 441 (1931).

4. 233 N.Y. 236, 135 N.E. 275 (1922).

5. The court stated:

> If liability for negligence exists, a thoughtless slip or blunder, the failure to detect a theft or forgery beneath the cover of deceptive entries, may expose accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class. The hazards of a business conducted on these terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of a duty that exposes to these consequences....

Ultramares Corp. v. Touche, 255 N.Y. 170, 179-80, 174 N.E. 441, 444 (1931).

6. Texas Tunneling Co. v. City of Chattanooga, 329 F.2d 402 (6th Cir. 1964) (surveyors); Sickler v. Indian River Abstract & Guar. Co., 142 Fla. 528, 195 So. 195 (1940)

to be true without any knowledge as to its truth, and a subsequent decision by the same court in a similar action[7] allowed the jury to infer fraud from a grossly negligent failure to detect and reveal materially dishonest conditions.[8]

Following *Ultramares*, the rule applied when investors or creditors sought recovery from accountants was that in the absence of a contractual relationship between the parties, liability could be founded only on fraud.[9] On the other hand, when a physical force was negligently set in motion to the injury of person or property, lack of privity of contract, as for warranty liability, was no defense.[10] This distinction between negligent acts and negligent words in determining the scope of liability was widely upheld until recently when the California Supreme Court, in *Biakanja v. Irving*,[11] permitted the beneficiary under a will to recover her loss from the notary who prepared the instrument when it was denied probate due to his negligence in failing to have it attested. The court gave the following guidelines for determining whether or not to permit recovery in a non-privity situation:

> The determination whether in a specific case the defendant will be held liable to a third person not in privity is a matter of policy and involves the balancing of various factors, among which are the extent to which the transaction was intended to affect the plaintiff, the foreseeability of harm to him, the degree of certainty that the plaintiff suffered injury, the closeness of the connection between the defendant's conduct and the injury suffered, the moral blame attached to the defendant's conduct, and the policy of preventing future harm.[12]

The court in *Biakanja* followed the position of the *Restatement*[13] which has been followed by only a minority of jurisdictions[14] and generally only

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(abstractor); National Iron & Steel Co. v. Hunt, 312 Ill. 245, 143 N.E. 833 (1924) (inspector); Rosenberg v. Cyrowski, 227 Mich. 508, 198 N.W. 905 (1924) (attorney); Jaillet v. Cashman, 235 N.Y. 511, 139 N.E. 714 (1923) (operator of ticker service); Peterson v. Gales, 191 Wis. 137, 210 N.W. 407 (1926) (abstractor).

7. State Street Trust Co. v. Ernst, 278 N.Y. 104, 15 N.E.2d 416 (1938).

8. This has been criticized as rendering "lip service to Derry v. Peek and yet allow[ing] recovery in deceit for misrepresentation which falls short of actual intent to deceive." W. PROSSER, TORTS 714 (3d ed. 1964). *See also* Comment, 41 ST. JOHNS L. REV. 588, 594 (1967). *Ultramares* has likewise been criticized as an unnecessary shift from negligence to fraud in determining the scope of duty. *See* Comment, 12 VAND. L. REV. 797 (1959).

9. *See, e.g.*, O'Connor v. Ludlam, 92 F.2d 50 (2d Cir. 1937); Beardsley v. Ernst, 47 Ohio App. 241, 191 N.E. 808 (1934); American Indem. v. Ernst & Ernst, 106 S.W.2d 763 (Tex. Civ. App. 1937); Candler v. Crane Christmas & Co., [1951] 1 All E.R. 426.

10. MacPherson v. Buick Motor Co., 217 N.Y. 382, 111 N.E. 1050 (1916).

11. 49 Cal. 2d 647, 320 P.2d 16 (1958).

12. *Id.* at 650, 320 P.2d at 19.

13. RESTATEMENT OF TORTS § 552.

14. United States v. Neustadt, 281 F.2d 596 (4th Cir. 1960); Texas Tunneling Co. v. City of Chattanooga, 204 F. Supp. 821 (E.D. Tenn. 1962), *rev'd*, 329 F.2d 402 (6th Cir. 1964); United States v. Rogers & Rogers, 161 F. Supp. 132 (S.D. Cal. 1958); Hardy v. Carmichael, 207 Cal. App. 2d 218, 24 Cal. Rptr. 475 (1962); M. Miller Co. v. Central Contra Costa Sanitary Dist., 198 Cal. App. 2d 305, 18 Cal. Rptr. 13 (1961); Lucas v. Hamm, 15

when the misrepresentation is made with knowledge and with the intent that the particular plaintiff rely upon it.[15]

There is also strong indication that the English courts will no longer allow lack of privity to bar recovery in certain situations where a duty ought to be owing. In *Hedley Byrne Co. v. Heller & Partners*,[16] the House of Lords, although denying recovery because of a valid disclaimer, went to great lengths in evaluating English precedent[17] and concluded that, as a general rule, a party will be liable for pecuniary harm resulting from a negligent misrepresentation even in the absence of a contract or fiduciary relationship.

The problem of determining the scope of liability for negligent breach of contract producing economic loss is particularly vexing when accountants are involved. The accounting profession seeks to gain prestige by encouraging reliance upon their work and yet seeks to avoid liability when an investor or creditor does so. Accountants argue that legal scholars urging extension of liability lack a practical understanding of the auditor's work.[18] Legal writers on the other hand argue that,

> The legal duties of the auditor ought to be co-extensive with his professional pretensions. He aspires to more than being a rubber

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Cal. Rptr. 821, 364 P.2d 685 (1961) (dicta); Duro Sportswear, Inc. v. Cogen, 131 N.Y.S.2d 20 (1954), *aff'd*, 285 App. Div. 864, 137 N.Y.S.2d 829; Howell v. Betts, 211 Tenn. 134, 362 S.W.2d 924 (1962) (dicta); Walker Bank & Trust Co. v. First Security Corp., 9 Utah 2d 215, 341 P.2d 944 (1959); Anderson v. Spriestersbach, 69 Wash. 393, 125 P. 166 (1912).

15. The draftsmen of the *Restatement* have recognized that their position was unsupported by authority and have attempted to compromise their original position which permitted recovery "by the person or one of the class of persons for whose guidance the information was supplied. . . ." RESTATEMENT (SECOND) OF TORTS § 552.

The proposed position now reads:

> (2) [T]he liability . . . is limited to loss suffered
> (a) by the person or one of the persons for whose benefit and guidance he *knows* the information to be intended; and
> (b) through reliance upon it in a transaction in which it is *intended* to influence his conduct.

RESTATEMENT (SECOND) OF TORTS § 552 (Tent. Draft No. 11, 1965) (emphasis added).

16. [1963] 2 All E.R. 575.

17. The court gave great weight to the analysis of Lord Denning who dissented in Candler v. Crane Christmas & Co., [1951] 1 All E.R. 426, arguing that accountants owe a duty of care not only to their own clients but also to all those whom they know will rely on their accounts in the transactions for which those accounts are prepared. Lord Denning also pointed out the error that had been committed in reducing *Derry v. Peek* to a flat rule of law:

> [A]t the time it was decided current legal thought was infected by two cardinal errors. The first was . . . that no one who is not a party to a contract can sue on it or on anything arising out of it. This error has had unfortunate consequences both in the law of contract and in the law of tort . . . . [I]t led the lawyers of that day to suppose that, if one of the parties to a contract was negligent in carrying it out, no third person who was injured by that negligence could sue for damages on account of it . . . . The second error . . . was . . . that no action ever lies for a negligent statement even though it is intended to be acted on by the plaintiff and is, in fact, acted on by him to his loss.

Candler v. Crane Christmas & Co., [1951] 1 All E.R. 426 at 431-2.

18. Coakley, *Accountants' Legal Liability*, J. ACCOUNTANCY 58 (July 1968).

> stamp for management, so his legal duties ought to go beyond that status.[19]

The courts are mindful of Cardozo's arguments in *Ultramares* against imposing upon a profession an enormous potential liability which is far out of proportion to the fault involved. Yet it is argued that the innocent creditor or investor may also face financial ruin if recovery is denied.[20] The problem, then, is to find a rule of law which eliminates liability to the large class of persons who could conceivably rely on the negligent statement but which also extends liability beyond the contracting parties to a small group whom the defendant expects and intends to influence.

The District Court of Appeal, Second District, in the instant case reasoned that recovery was precluded by the rule in *Sickler v. Indian River Abstract & Guaranty Co.*,[21] a case involving the liability of an abstractor for negligence to a mortgagee who relied on the abstract. The *Restatement* position[22] was rejected as being in conflict with the precedent of *State Street Trust Co. v. Ernst*.[23]

Thus the court relied heavily on the language of a precedent involving another profession in formulating the rule to be applied, and the question of whether there is a situation in which persons not in privity could recover their economic losses was not left open. Therefore, it can fairly be concluded that in Florida, when there is a lack of privity, there can never be recovery for financial losses suffered as a result of negligent performance of a contract. This would not preclude the Florida courts from permitting recovery for fraudulent misrepresentations by allowing fraud to be inferred from grossly negligent conduct,[24] nor would a finding that a third party beneficiary contract exists be precluded where the facts so warrant. This being the case, it is conceivable that the *scienter* requirement could be relaxed whenever the court determines that justice requires recovery by the third party.

This writer would favor an approach which attempts to solve the problem of the scope of the accountant's liability rather than the approach taken by the court which would preclude recovery in all instances. Under the present state of the law, however, when large sums are involved, serious investors should employ their own C.P.A. to conduct the audit. Alternatively, the prudent investor should become an express third party beneficiary of the contract with the C.P.A. who performs the audit, thus eliminating the roadblock of privity.

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19. Bradley, *Liability to Third Persons for Negligent Audit*, 1966 J. BUS. L. 190.
20. *See* Comment, 41 ST. JOHNS L. REV. 588, 600 (1967).
21. 142 Fla. 528, 195 So. 195 (1940).
22. *See* note 15 *supra*.
23. 278 N.Y. 104, 15 N.E.2d 416 (1938).
24. According to the precedent relied upon, liability for fraudulent misrepresentations by accountants extends to the foreseeable class of persons who justifiably rely on them. Ultramares Corp. v. Touche, 255 N.Y. 170, 174 N.E. 441 (1931); State St. Trust v. Ernst, 278 N.Y. 104, 15 N.E.2d 416 (1938).