The Pendulum of Accountants' Liability Swings Against Accountants: A Plaintiff's Perspective

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Table of Contents

INTRODUCTION 3

AUDITING AS A COMMODITY 4

BRINGING A CASE AGAINST AN ACCOUNTANT 4

I. EVALUATING AN ACCOUNTANT'S SOLVENCY 4
II. REQUIREMENTS OF MINN. STAT. § 544.42 5
III. CAUSES OF ACTION FOR ACCOUNTANT LIABILITY 7
A. Negligent Misrepresentation *7*
B. Intentional Misrepresentation *8*
IV. DEFENSES AND LIMITATIONS ON LIABILITY 8
A. Standing of Plaintiff *8*
V. THE THREE STANDARDS FOR REASONABLE RELIANCE 10
A. Common Law Privity *10*
B. The "Foreseeability" Test *10*
C. Restatement (Second) of Torts § 552 . . . . *11*
VI. THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995 13
VII. WHERE IS ACCOUNTING REFORM HEADED? 14
VIII. CONCLUSION 15

Introduction

The[i] recent accounting scandals uncovered in the last two years involving numerous Fortune 500 companies have had a devastating affect on the nation's economy and, more importantly, our trust in the companies in which we invest. To name a few: Enron, Qwest, Xerox[ii] and WorldCom are recent examples where accounting practices and standards have come under the microscope. As recognized by Senator Sarbanes from Maryland, "there were 157 financial restatements by companies in 2000, 207 in 1999, and 100 in 1998. The 3-year total of 464 was higher than the previous 10 years combined, during which the average number of restatements was 46 each year. This is a dramatic increase in the number of restatements."[iii] The above-named companies' financial disclosures (or lack thereof) and their accountants' questionable practices have spawned a great deal of litigation.

In a recent poll, four out of five people said they think questionable accounting is a widespread practice in the business world.[iv] The Wall Street Journal gave this summary of the problem:

> The institutions that were created to check such abuses failed. The remnants of a professional ethos in accounting, law and securities analysis gave way to the maximum revenue per partner. The auditor's signature on a corporate report didn't testify that the report was an accurate snapshot, said [Treasury Secretary Paul] O'Neill. He says it too often meant only that a company had "cooked the books to generally accepted standards."

As accounting standards come under the scrutiny of politicians and the public, the courts may also change their view regarding accountant liability. With political and public outrage over these most recent scandals, the courts may be more "open-minded" to a claim for accountant liability when creditors, investment banks, and shareholders bring suit against the company for misstating its financial health.

As Congress, the Securities and Exchange Commission, and state legislatures scramble to tighten controls on accounting practices and standards, this Continuing Legal Education section will mainly cover accountant liability regarding what types of claims may be brought, what limitations and defenses exist, and how one would go about determining whether a claim should be brought. Also, we will discuss new federal legislation regarding accountant liability, and how it may favorably change the law from the plaintiff's perspective.

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Auditing as a Commodity

As recent as the 1990's, financial accounting and auditing were considered "loss leaders" for many of the larger accounting firms. Auditing as a commodity or being a "loss leader" means that the accounting firm would agree to conduct the outside accounting and audit work for the respective company at lower rates than it would normally charge in hope of landing other, more lucrative, projects like business consulting or tax planning services. Testifying before Congress, James E. Burton, the CEO of the California Public Employees' Retirement System, CalPERS, which manages pension and health benefits for more than 1.3 million members and has aggregate holdings of $150 billion stated:

> The inherent conflicts created when an external auditor is simultaneously receiving fees from a company for non-audit work cannot be remedied by anything less than a bright line ban. An accounting firm should be an auditor or a consultant, but not both to the same client.

In 1988, according to the SEC, 55 percent of the average revenue of the big five accounting firms came from accounting and auditing services; 22 percent came from management consulting services. By 1999, only 10 years later, these figures had fallen to 31 percent for accounting and auditing services, and 50 percent for management consulting services.

Now, accounting firms, for credibility reasons, if not because of new legal obligations arising through the passage of accounting reform legislation, must conduct its accounting and auditing business for profit. The effect this will have on business is two-fold. First, the accounting firm will have to dramatically increase the rates it charges for such services. Second, the more lucrative consulting projects will be awarded to its competitors. While accounting firms may not look favorably upon this type of new business practice, it is clear that the use of "loss leaders" will no longer be tolerated.

Bringing a Case Against an Accountant

I. EVALUATING AN ACCOUNTANT'S SOLVENCY

Like any other case that comes through the door of a plaintiff's law firm, one of the first questions that must be affirmatively answered is whether the defendant is solvent. Traditionally, in the context of accountant liability, the simple answer was always: "of course." With the impending downfall of accounting firms such as Arthur Andersen, and large money class-action lawsuits against other accounting firms, a plaintiff lawyer must look to see how many and to what extent the lawsuits pending against the accountant and his or her accounting firm. Indeed, if one sued Arthur Anderson three years ago, one would not think twice about the collectibility or solvency issue. Now, one would have to stand in line behind others who have potentially hundreds of millions of dollars in claims. Therefore, it is worth the lawyer's time to investigate the defendant's ability to pay claims before drafting the complaint.

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II. REQUIREMENTS OF MINN. STAT. § 544.42

Under Minnesota law, there are certain hurdles that must be cleared before a plaintiff may bring any claim against an accountant and his or her firm for their negligent accounting practices. According to Minn. Stat. § 544.42: Actions against professionals; certification of expert review: In an action against a professional alleging negligence or malpractice in rendering a professional service where expert testimony is to be used by a party to establish a prima facie case, the party must:

- unless otherwise provided in subdivision 3, paragraph (a), clause (2) or (3), serve upon the opponent with the pleadings an affidavit as provided in subdivision 3; and
- (2) serve upon the opponent within 180 days an affidavit as provided in subdivision 4.
- Subd. 3. Affidavit of expert review. (a) The affidavit required by subdivision 2, clause (1), must be drafted by the party's attorney and state that:
- the facts of the case have been reviewed by the party's attorney with an expert whose qualifications provide a reasonable expectation that the expert's opinions could be admissible at trial and that, in the opinion of this expert, the defendant deviated from the applicable standard of care and by that action caused injury to the plaintiff;
- (2) the expert review required by clause (1) could not reasonably be obtained before the action was commenced because of the applicable statute of limitations; or
- (3) the parties have agreed to a waiver of the expert review required by clause (1) or the party has applied for a waiver or modification by the court under paragraph (c).
- (b) If an affidavit is executed under paragraph (a), clause (2), the affidavit in paragraph (a), clause (1), must be served on the defendant or the defendant's counsel within 90 days after service of the summons and complaint.
- (c) The certification of expert review required under this section may be waived or modified if the court where the matter will be venued determines, upon an application served with commencement of the action, that good cause exists for not requiring the certification. Good cause includes, but is not limited to, a showing that the action requires discovery to provide a reasonable basis for the expert's opinion or the unavailability, after a good faith effort, of a qualified expert at reasonable cost. If the court waives or modifies the expert review requirements, the court shall establish a scheduling order for compliance or discovery. If the court denies a request for a waiver under this subdivision, the plaintiff must serve on the defendant the affidavit required under subdivision 2, clause (1), within 60 days, and the affidavit required under subdivision 2, clause (2), within 180 days.

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- Subd. 4. Identification of experts to be called. (a) The affidavit required by subdivision 2, clause (2), must be signed by the party's attorney and state the identity of each person whom the attorney expects to call as an expert witness at trial to testify with respect to the issues of negligence, malpractice, or causation, the substance of the facts and opinions to which the expert is expected to testify, and a summary of the grounds for each opinion. Answers to interrogatories that state the information required by this subdivision satisfy the requirements of this subdivision if they are signed by the party's attorney and served upon the opponent within 180 days after commencement of the action against the defendant or within 180 days after service of the affidavit required by subdivision 3, paragraph (a), clause (2) or (3).
- (b) The parties by agreement, or the court for good cause shown, may provide for extensions of the time limits specified in subdivision 2, 3, or this subdivision. Nothing in this subdivision prevents any party from calling additional expert witnesses or substituting other expert witnesses.
- Subd. 5. Responsibilities of party as attorney. If a party is acting pro se, the party shall sign the affidavit or answers to interrogatories referred to in this section and is bound by those provisions as if represented by an attorney.
- Subd. 6. Penalty for noncompliance. (a) Failure to comply with subdivision 2, clause (1), within 60 days after demand for the affidavit results, upon motion, in mandatory dismissal of each cause of action with prejudice as to which expert testimony is necessary to establish a prima facie case.
- (b) Failure to comply with subdivision 3, paragraph (b) or (c), results, upon motion, in mandatory dismissal of each cause of action with prejudice as to which expert testimony is necessary to establish a prima facie case.
- (c) Failure to comply with subdivision 4 results, upon motion, in mandatory dismissal of each action with prejudice as to which expert testimony is necessary to establish a prima facie case, provided that an initial motion to dismiss an action under this paragraph based upon claimed deficiencies of the affidavit or answers to interrogatories shall not be granted unless, after notice by the court, the nonmoving party is given 60 days to satisfy the disclosure requirements in subdivision 4. In providing its notice, the court shall issue specific findings as to the deficiencies of the affidavit or answers to interrogatories.
- Subd. 7. Consequences of signing affidavit. The signature of the party or the party's attorney constitutes a certification that the person has read the affidavit or answers to interrogatories, and that to the best of the person's knowledge, information, and belief formed after a reasonable inquiry, it is true, accurate, and made in good faith. A certification made in violation of this subdivision subjects the attorney or party responsible for that conduct to reasonable attorney's fees, costs, disbursements, and other damages that may be determined by the court.

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Although Minnesota case law has not addressed the strict requirements of Minn. Stat. § 544.42, the statute is clear that before a claim may be brought for accountant liability, certain procedural steps must be fulfilled prior to such filing.

III. CAUSES OF ACTION FOR ACCOUNTANT LIABILITY

The two main causes of action for accountant liability are negligent and intentional misrepresentation. While an accountant may be held liable to a client (and/or others) on other theories (i.e. breach of fiduciary duty and state and federal securities laws), we will focus on negligent and intentional misrepresentation.

A. Negligent Misrepresentation

The first element of a negligent misrepresentation claim against an accountant is the furnishing of false information by the accountant during the course of his business, profession and employment. To be actionable, the information must also have been supplied for the guidance of others in their business and the accountant must have failed to exercise reasonable care or competence in obtaining or communicating the information. Finally, the plaintiff's reliance upon the information must have been justified and that reliance had to have been a direct cause of plaintiff's damage, consisting of actual monetary loss.

The key inquiry to state a claim for negligent misrepresentation is whether the accountant asserted a fact "of his own knowledge without knowing whether it is true or false." As explained in the leading case of Florenzanno v. Olson:

> A misrepresentation is made negligently when the misrepresenter has not discovered or communicated certain information that the ordinary person in his or her position would have discovered or communicated. Proof of the subjective state of the misrepresenter's mind, whether by direct evidence or by inference, is not needed to prove negligence. Negligence is proved by measuring one's conduct against an objective standard of reasonable care or competence.

387 N.W.2d 168, 174 (Minn. 1986). At the same time, no one is held to warrant the truth of all statements made in good-faith. A non-negligent mistake will not establish misrepresentation under either a claim for fraudulent or negligent misrepresentation.

To satisfy the reliance element of a negligent misrepresentation case, the plaintiff must establish that his reliance is reasonable. The reasonableness of this reliance is measured with reference to the "specific intelligence and experience" of the plaintiff. See Midland Nat'l. Bank of Minneapolis v. Perranoski, 299 N.W.2d 404, 411 (Minn. 1980) (citing Murphy v. Country House Inc., 307 Minn. 344, 351, 240 N.W.2d 507, 512 (1976). In accountant liability cases, the plaintiff is typically well-educated and sophisticated. Therefore, the bar may be set somewhat higher than a typical plaintiff in a negligence action.

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B. Intentional Misrepresentation

The chief distinction between fraudulent misrepresentation and negligent misrepresentation lies in the element of intent. Of course, all elements of the tort must be established by "clear and convincing" evidence – a higher standard than the normal "preponderance of the evidence" burden. To establish a claim of fraudulent misrepresentation, the plaintiff is required to show that the misrepresentation was made with "fraudulent intent," or in other words, with "dishonesty or bad faith." As explained in Florenzano:

> What the misrepresenter knows or believes is the key to proof of intent. Wrongful intent, as a state of mind, is rarely proved directly, e.g., by an admission of bad faith, but is normally established through circumstantial evidence. There is no doubt of fraudulent intent where the misrepresenter knows or believes the matter is not as he or she represents it to be. Fraudulent intent is also present when a misrepresenter speaks positively and without qualification, but either is conscious of ignorance of the truth, or realizes that the information on which he or she relies is not adequate or dependable enough to support such a positive, unqualified assertion.

387 N.W.2d at 173. As a general matter, a claim of fraud can only be based upon representations of past or existing facts. See Cady v. Bush, 283 Minn. 105, 109, 166 N.W.2d 358, 361 (1969). Representations about the future are usually not sufficient bases for fraud actions. This is because representations concerning the future are treated as nothing more than conjecture and opinion. Id. Despite this general rule, an accountant can be found liable for the expression of opinion concerning future events where the accountant is relied upon for his expertise concerning the subject of the statement. See Kennedy v. Flo-Tronics, Inc., 274 Minn. 327, 334, 143 N.W.2d 827, 831 (1966). An accountant can also be liable for misrepresentations about present or past facts contained in a pro forma projection about future events. See Berg v. Xerxes-Southdale Office Bldg. Co., 290 N.W.2d 612, 615 (Minn. 1980).

IV. DEFENSES AND LIMITATIONS ON LIABILITY

A. Standing of Plaintiff

An issue emerging with increasing frequency is the question of whether the plaintiff actually has standing to pursue a claim against the defendant accountant. The closely related concept of "privity defense" is discussed below.

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As a general proposition, a plaintiff does not have standing to maintain an action unless the plaintiff has some individual or representative interest in the cause of action. To establish standing, a plaintiff must show that he or she has a legally protected interest that the defendant has invaded, and that he or she will be benefitted by the relief sought.

In the case of an action against an accountant, the accountant's direct client has standing to maintain an action for professional negligence. Where such an action is based in contract, the client is the party to the contract with the accountant and has standing to sue. In a tort action, it is the client who has suffered harm from the alleged misconduct.

Significant standing issues can also be found in situations where a trustee or receiver seeks to assert claims against an accountant for negligently failing to discover that management was looting the assets of the audit client. Competing public interests have led some courts to allow such representatives to pursue accountants without imputation of wrongdoing by the management of the failed company. See Bonhiver, *supra*. Other courts have limited the ability of such a representative to recover against accountants charged with failing to discover management fraud. Redington v. Touche Ross & Co., 592 F.2d 617 (2nd. Cir. 1978).

The identification of the accountant's true client is sometimes clouded by the nature of the accountant's relationship with a constellation of closely related clients. This typically occurs where the accountant's direct clients consist of a closely held corporation and its controlling shareholder. Many accountants frequently provide all of the tax, accounting, and auditing services to closely held corporations and their controlling sharehoders. The comprehensive nature of these types of engagements sometimes leads to confusion as to whom the accountant is serving.

Where such confusion is present, a plaintiff might attempt to assert an action on behalf of both the corporation and the controlling shareholder, even where the accountant's alleged negligence has damaged only the corporation. This typically occurs on engagements arising out of negligence asserted in the preparation of financial statements and a resulting failure to detect employee defalcation, as well as when a corporation claimed to have overpaid taxes and the shareholders later brought suit in their own names for the overpayment, following their sale of all stock in the company.

The general rule is that a shareholder does not have standing to bring an action for damages suffered by a corporation. Wessin v. Achieves Corp., 592 N.W.2d 460 (Minn. 1999). Instead, a shareholder is allowed to bring an action derivatively, on behalf of the corporation and against a defendant accountant, where the shareholder meets the requirements of Federal Rule of Civil Procedure 23.1 (See also Minn. R. Civ. P. 23.01 et. seq.):

- The corporation must have failed to enforce a properly assertable right against the CPA.
- The complaint must be verified by the shareholder.

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- The plaintiff must allege that he or she was a shareholder at the time of the transaction in question or that plaintiff acquired stock thereafter by operation of law.
- The plaintiff must allege that the action is not brought collusively to confer jurisdiction on a federal court.
- The complaint must allege with "particularity" efforts made by plaintiff to obtain action from the directors of the corporation and the reasons for the failure to obtain the requested action or for not making the required effort.
- The action can only be maintained by a plaintiff who fairly and adequately represents the interests of similarly situated shareholders.

As with a class action, court approval is required for settlement of a shareholders' derivative claim.

V. THE THREE STANDARDS FOR REASONABLE RELIANCE

Courts have traditionally used one of three different rules in determining when an accountant is liable for negligent work upon which a third party relied. While reliance is generally a question of fact, Minnesota courts, as illustrated below, have curiously treated it as a question of law that can be decided before trial.

A. Common Law Privity

At common law, like most causes of action related to professional malpractice, an accountant could only be held liable to those that he or she was held to be in privity. As this rule only protected the company against accountant liability, it had harsh results for creditors, investors and other shareholders. The traditional "privity" rule, which is the most restrictive rule, was set out in Ultramares Corp. v. Touche, 174 N.E. 441 (N.Y. 1931). The privity rule, which would provide that accountants are not liable to non-clients, has been rejected and roundly criticized–for good reason. Audit reports are often obtained precisely for the purpose of satisfying third parties that a company's finacial statements can be relied upon. Minnesota has appropriately rejected the privity rule for accountants.

B. The "Foreseeability" Test

To soften the harsh result that generally accompanied decisions based on privity, several state courts have adopted a more expansive rule that holds auditors accountable to all foreseeable users of audit reports who rely on the audit report to their detriment. See H. Rosenblum, Inc. v. Adler, 461 A.2d 138 (N.J. 1983); Citizens State Bank v. Timm, Schmidt & Co., 335 N.W.2d 361 (Wis. 1983); Touche Ross & Co. v. Commercial Union Ins. Co., 514 So. 2d 315 (Miss. 1987).

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In the foreseeability approach, an auditor has a duty to all those whom the auditor should reasonably foresee as receiving and relying on the audited statements. Rosenblum, 461 A.2d at 153. Under this line of cases, if the parties intended the plaintiff to rely on the accountant-company relationship, then the accountant could be held liable to that third party.

C. Restatement (Second) of Torts § 552

The Restatement (Second) of Torts § 552 dramatically changed the legal landscape of accountant liability. Facially, it appears as if the drafters of § 552 desired to draw the line somewhere between privity and foreseeability. Under § 552: Information Negligently Supplied for the Guidance of Others:

(1) One who, in the course of his business, profession or employment, or in a transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

(2) Except as stated in subsection (3), the liability stated in subsection (1) is limited to loss suffered

 (a) By the person or one of the persons for whose benefit and guidance he intends to supply the information, or knows that the recipient intends to supply it; and

 (b) Through reliance upon it in a transaction which he intends the information to influence, or knows that the recipient so intends, or in a substantially similar transaction.

Despite its plaintiff-friendly language, Minnesota courts, relying upon § 552, have been very reluctant to hold in favor of plaintiffs in accountant liability cases.

In the seminal case of Bonhiver v. Graff, 248 N.W.2d 291 (Minn. 1976), an accountant and his firm were held liable for professional malpractice under the guise of § 552. In so holding, the court stated that "[t]he defendants' actual knowledge that the [third-party] was relying upon these representations renders them liable for their negligence in making them." Bonhiver, 248 N.W.2d at 298. While not adopting the more relaxed foreseeability test argued by the plaintiffs, the court stated:

> [T]he extent of an accountant's liability for malpractice is not settled. If that liability is to be drawn somewhere short of foreseeability, it must be drawn on pragmatic grounds alone. Once it is admitted that a certain number of people have been injured as a result of an accountant's malpractice, there is no logical justification for denying any of them relief based upon the "limited" or "unlimited" nature of their "class," or whether the reliance of the particular injured parties was or was not "specifically foreseeable."

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248 N.W.2d at 302. It is important to note that in Bonhiver, the plaintiff was determined to be within the class of persons to be protected because of the agency relationship it had with the audited company. Therefore, the line drawn in the Bonhiver case fell on the side of allowing the plaintiff to recover. Although the plaintiff was allowed recovery in the Bonhiver case, however, the court blurred more than made clear the line to be drawn in future cases.

In TCF Banking & Sav. F.A. v. Arthur Young & Co., 706 F. Supp. 1408, 1417-18 (D. Minn. 1988), the court rejected the accountants' argument that the accountants must have actual knowledge of the plaintiff's reliance on the accountants' representations to establish liability. Id. at 1419. The accountants argued that because their audit was conducted for the 1983 annual report and the loan was made to the shareholders in 1984, plaintiff could not prove actual knowledge by the accountants that TCF would rely on the accountants' representations in the financial statements. Id. at 1419. The court rejected the accountants' defense, stating "nowhere does Bonhiver explicitly require actual knowledge of reliance by a particular plaintiff." Id. Indeed, the TCF Banking court's determination on this issue is consistent with one of the comments in the Restatement. "It is sufficient . . . that the maker supplies the information for repetition to a certain group or class of persons and that the plaintiff proves to be one of them, even though the maker never had heard of him by name when the information was given." Restatement (Second) of Torts § 552 comment h (1977). The TCF Banking court described the necessary showing for accountant liability under the Restatement:

> Thus, plaintiff need not prove defendant's actual knowledge of plaintiff's reliance on its audit and financial statements to prove its malpractice claim. . . . [P]laintiff need only show either (1) that defendant intended to induce creditors to loan money . . . in exchange for a security interest in [the] stock; or (2) that defendant knew its client would use the audit and financial statements to induce creditors to loan money . . . in exchange for [the] stock.

Id. at 1419 (internal citations omitted). Therefore, in following Bonhiver, the federal court in Minnesota held the accountants liable under § 552.

In Mahoney & Walling Prof. Ass'n. v. Oberweis Securities, Inc., 1990 Minn. App. LEXIS 643 (Minn. Ct. App. July 3, 1990), a law firm sued an accounting firm for, among other things, negligent misrepresentation. In Mahoney, the plaintiff alleged that the defendant accounting firm failed to list the debt owed to the plaintiff on the defendant's client's financial statement, and therefore, committed negligent misrepresentation. The district court granted the defendants' motion for summary judgment and the court of appeals affirmed. The court, relying on § 552, stated that one "cannot owe a duty of care in the preparation or communication of information to a party who does not obtain or use that information." Id. at *5. Therefore, the plaintiff did "not meet section 552's definition of negligent misrepresentation, let alone its limitations." Id. at *4.

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In Noram Investment Services, Inc. v. Stirtz Bernards Boyden Surdel & Larter, P.A., 611 N.W.2d 372 (Minn. Ct. App. 2000), the court held that an accounting firm could not be held liable to a securities broker who relied on the accountant's report to extend margin credit to its customers. Although the only reason the company requested an audit was so that it could be publicly traded, the court stated that "the chain of reliance here is several links longer than the chain in Bohiver," therefore, § 552 did not apply. Id. at 375. The court intimated the same sentiments relayed in the Ultramares case that to hold an accounting firm liable to third-parties who it knows relies on "could lead to virtually unlimited liability." Id. at 375.

In Dakota Bank v. Eiesland, 2002 Minn. App. LEXIS 662 (Minn. Ct. App. June 11, 2002), the court held that, as a matter of law, a third-party could not justifiably rely on unaudited financial statements when a disclaimer is present. Despite the fact that the auditor knew the bank would base its decision to loan the company money on the financial statements complied by the auditor, the court held that it did not matter. The court stated: "[T]he disclaimer, in clear and unambiguous language, warned any party seeking to rely on the compiled information of the severe, if not complete, limitations placed on such reliance." Id. at *13.

Based on the above-mentioned Minnesota cases, it appears that Bonhiver has been severely watered down. Under Minnesota's current application of § 552, it appears that plaintiffs suing accountants and their accounting firm for negligent misrepresentation for debacles such as Enron or WorldCom would not prevail. In fact, recent case law tells us that a plaintiff could not get passed a motion to dismiss for failure to state a claim. In light of the recent developments in legislation, however, it remains to be seen whether the Minnesota courts may accept the view that third-parties justifiably rely on auditing opinions and prospectuses, and thus, meet the requirements of § 552.

VI. THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

Under the Private Securities Litigation Reform Act of 1995 (the "PSLRA"), accountants have been given somewhat of a free pass to commit malpractice. This is because the PSLRA replaced the doctrine of joint and several liability with proportionate liability. Under the traditional system of joint and several liability, joint tortfeasors are each liable for the investor's entire loss. Congress was concerned that, as a result, defendants with relatively little culpability were being forced to pay the entire loss because the more culpable defendants were often judgment-proof. Some believe that joint and several liability contributed to the increase in lawsuits by creating coercive pressure for innocent parties to settle meritless lawsuits rather than risk being held liable for the plaintiff's entire loss.

Under the PSLRA, joint and several liability is eliminated in all cases except where the defendant's violation was "knowing" or when the plaintiff's loss was more than 10 percent of his or her net worth so long as the plaintiff's net worth does not exceed $200,000. In place of joint and several liability, Congress adopted a system of proportionate liability.

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Under proportionate liability, the jury will be asked to assign (as a percentage) responsibility for the plaintiff's loss to all persons claimed by any party to have been responsible. Defendants will pay only for their share of the total damages. If one or more responsible parties are judgement-proof, their liability is allocated back to the other responsible parties. No party, however, shall be required to pay more than a total of 150 percent of its own proportionate share of the loss.

The change from joint and several liability to proportionate liability is perhaps the most significant change included in the PSLRA. It applies to individual as well as to class actions, and shifts more of the risk that some defendants will be judgement-proof from the joint tortfeasor to the investor.

VII. WHERE IS ACCOUNTING REFORM HEADED?

In response to the latest accounting scandals, Congress has been earnestly drafting legislation what will soon to be known as the "Truth in Accounting Act of 2002." Moreover, there is another Bill making its way through Congress entitled the "Public Company Accounting Reform and Investor Protection Act of 2002." From the outset, it appears that the Acts will create a self-governing, non-agency, accounting oversight board to regulate accountants and auditors in their practice. The Acts will increase the criminal penalties for violations thereof including stiffer penalties regarding document-retention violations. Moreover, the Acts will also clearly make auditing as a commodity an illegal practice.

As both the Senate and House of Representatives try to "out do" each other when it comes to raising the criminal penalties for violating the Act, it is unclear whether a private claimant will have a cause of action for any violations thereof. Under the current drafts of either Act, there is no express provision granting aggrieved parties a private cause of action for a violation of the Act in federal court.

Of course, there is no express private cause of action found in 10(b) of the Securities Act of 1934. However, the United States Supreme Court has held that an implied private cause of action exists under 10(b). <u>See</u> <u>Blue Chip Stamps v. Manor Drug Stores</u>, 421 U.S. 723 (1975). As the Supreme Court recognized in <u>Blue Chip Stamps</u>, "[w]hen we deal with private actions under Rule 10b-5, we deal with a judicial oak which has grown from little more than a legislative acorn." 421 U.S. at 737. Therefore, it will be important to watch whether the final version of the "Truth in Accounting Act of 2002" or the "Public Company Accounting Reform and Investor Protection Act of 2002" will contain an express private cause of action under the Act and, if not, whether the courts interpret that one is implied. The stated purpose of the latter Bill is "to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes." We will soon find out how far Congress, and the courts, will go to protect investors from shoddy accounting and auditing practices.

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Furthermore, it is important to note that the House of Representatives version of the "Truth in Accounting Act of 2002" states: "The Congress finds the following . . . (2) Investors, creditors, and other consumers of financial reports rely heavily on credible, transparent, and comparable financial information." H.R. 3970 § 101. As the Legislature has now spoken on the issue of reliance, it will be interesting to see how courts treat the issue in future cases. To be sure, the Act, once passed, will certainly create debate over whether the pendulum has swung against accountants.

VIII. CONCLUSION

A chief economist was quoted in the Washington Post as saying: "The economy and markets right now are in the midst of a full-blown corporate governance shock. . . . To presume somehow that it's over or that the worst is behind us is naive."[4] While the ink is not yet dry on many of the newly proposed Bills drafted in Congress, there is certainly a shift or different perspective held by politicians and the public regarding accountant liability. In the courtroom, it is only a matter of time before the pendulum begins to head the other direction–against accountants. Whether the change favoring plaintiffs comes from new legislation, a shift in the interpretation of § 552, or through jury verdicts, it is clear that accountants and auditors cannot perform at a substandard level without some degree of liability. To say the least, as Bob Dylan sings, "Times, they are a change'n."

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[1] On July 1, 2002, Xerox disclosed that it would pay a $10 million civil penalty and restate four years of earnings following a more than two-year investigation into the company's accounting. See Wall Street Journal, July 3, 2002.

[2] U.S. Senate Banking Committee on Banking, Housing, and Urban Affairs, Senate Floor Statement - Monday, July 15, 2002.

[3] CBS News Poll, July 10, 2002.

[4] Washington Post, June 26, 2002.

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