NEW YORK'S HIGH COURT AGAIN CONSIDERS PRIVITY DOCTRINE *

by

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I. INTRODUCTION

"That's where the money is," reportedly is a statement ascribed to the bank robber Willie Sutton when he was asked why he robbed banks. In the legal arena, there is often analogous reasoning when someone is aggrieved and seeks redress. This is particularly true when an investment in or loans to an entity go sour. After the debacle, generally the only ones around with *deep pockets* from whom to seek compensation are the accountants and lawyers for the entity. A particularly favored target for lawsuits, of course, is the accounting firm that certified and/or prepared the financial statements of the entity. Consequently, accounting firms are frequently hit with lawsuits by disgruntled investors and lenders.

Over time, there is a tendency for basic legal principles to be eroded, or perhaps a better word is liberalized. This is particularly true with respect to the doctrine of privity of contract in general.[1] Insofar as accountants (and other professionals) are concerned, however, the privity doctrine is still alive and kicking, at least in the state of New York, as exemplified by two recent cases favoring accountants, discussed hereafter in this article. To fully understand the new decisions, however, a background review is apropos.

II. BACKGROUND

New York's highest court (the Court of Appeals) has long held that a party may recover in tort for pecuniary loss sustained as a result of another's negligent misrepresentation upon a showing of actual privity of contract or of a relationship approaching that of privity. The following are some of the more important of the Court of Appeals' prior decisions in this regard:

A. Glanzer v. Shephard[2]

Glanzer, an early seminal case involving the doctrine of privity, decided in 1922, involved a bean seller who contracted with public weighers directing them to furnish a copy of the weight certificate to a particular prospective buyer. The weight set forth on a certificate was inaccurate resulting in a loss to the buyer. Despite the absence of privity between the buyer and the weigher, the Court concluded that the weigher had a duty to the buyer because the representations at issue had been made "for the very purpose of inducing action" on the part of the buyer.[3] The buyer's use of the weight certificate was not a byproduct of the actions of the weigher, but a consequence of the action which to the weigher's knowledge was the "end and aim" of the transaction.[4]

B. Ultramares v. Touche [5]

In the later seminal case of *Ultramares*, decided in 1931, Chief Judge Benjamin Cardozo, speaking for the Court, set forth the parameters of an accountant's liability to third parties. In that case, Touche, Niven & Company ("Touche") performed an audit of Fred Stern & Co., Inc. ("Stern"). The plaintiff, a factor, had made loans to Stern relying upon the audit report of Touche. Although the audit report was not specifically prepared for the plaintiff, Touche was aware that Stern would use the audit report to obtain credit for its operations and other financial dealings (e.g., with banks, creditors, stockholders, purchasers or sellers) according to the needs of the occasion since it prepared numerous certified counterpart originals. Stern had given plaintiff a certified copy of the audit report. Touche had no prior knowledge, however, that the audit report would be given to plaintiff, or even that Stern had financial dealings with plaintiff. In its audit report, Touche certified that Stern's capital and surplus were intact when in fact both had been wiped out and the corporation was insolvent. Subsequently, Stern was declared bankrupt. It was pretty clear that the audit was performed negligently, and that at least with respect to part of the audit there was possibly gross negligence.

The plaintiff had brought two tort causes of action: one for negligent misrepresentation and a second for fraudulent misrepresentation. The defendant moved to dismiss both causes of action. The trial judge dismissed the fraud claim without submitting it to the jury, reserved decision on the negligence claim, and the case was submitted to the jury. The jury returned a verdict on the negligence cause of action in favor of plaintiff; however, the judge granted the reserved motion to dismiss on

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the negligence claim notwithstanding the verdict. The Appellate Division affirmed the dismissal on the fraud cause of action and reinstated the verdict on the negligence cause of action. Both parties appealed to the Court of Appeals.

Interestingly, the Court of Appeals reversed the Appellate Division on the negligence claim, dismissing that cause of action, and also reversed the Appellate Division on the dismissal of the fraud cause of action. As to that cause of action, it sent the matter back for a new trial.

1. Negligent Misrepresentation.

The plaintiff's basic premise was that liability should attach, even though privity is lacking, where words, whether written or oral, are negligently published with the expectation that the person to whom they are transmitted will transmit them to another. In this regard, the Court observed that the plaintiff would be correct if there was at least some bond approaching privity. But the Court held that this was not the case at hand. Here, the Court noted that there was no "contractual relation, or even one approaching it, at the root of any duty that was owing from the defendants now before us to the indeterminate class of persons who, presently or in the future, might deal with the Stern company in reliance on the audit."[6]

In *Ultramares*, there was no contractual relationship whatsoever owing from Touche to the "indeterminate class" of persons who dealt with or might deal with Stern in reliance on the audit.[7] The service rendered by Touche was primarily for the benefit of Stern. The Court acknowledged approvingly a principle clearly stated by Judge Roscoe Pound in an even earlier decision that " 'negligent words are not actionable unless they are uttered directly, with knowledge or notice that they will be acted on, to one to whom the speaker is bound by some relation of duty, arising out of public calling, contract or otherwise, to act with care if he acts at all.' "[8]

The Court thus concluded that liability for negligence was not applicable under the circumstances. To hold otherwise, he noted, would expand the field of liability for negligent speech to make it nearly coterminous with liability for fraud, and that negligence is not a substitute for fraud.

2. Fraudulent Misrepresentation.

On the other hand, the Court observed that an expert opinion could be found to be fraudulent if based upon flimsy grounds. Thus, an accountant could be held liable on the basis of fraud if the audit is so negligent as to conclude that the accountant had no real belief in its adequacy. The Court distinguished between honest blunder and reckless misstatement. In the former case, liability is based on contract and is to be enforced only as between the parties to the contract. In the latter case, the accountant's exposure is more broad-based, and could extend to third parties.

In *Ultramares*, Touche had certified as a fact, based upon its knowledge, that the balance sheet was in accordance with the books of account, which in fact was an untrue statement. In this regard, the Court noted that: "[N]egligence or blindness, even when not equivalent to fraud, is none the less evidence to sustain an inference of fraud. At least that is so if the negligence is gross."[9] The Court remarked that a jury might find that Touche had closed its eyes to the obvious, and that it had made a statement true to its own knowledge when in fact it had no knowledge on the subject. Accordingly, the Court reversed the judgment of the Appellate Division and granted a new trial on the issue of fraudulent misrepresentation.

3. Basic Principles

The *Ultramares* case thus set forth at least two basic principles regarding the liability of accountants, and for that matter other professionals similarly situated, such as attorneys, as discussed hereafter. First, it appears that in a tort action based upon negligent misrepresentation, contract principles are applicable and liability will not attach to third parties absent actual privity, or at least a "bond so close as to approach privity, if not one with it."[10] Second, in a tort action based upon fraudulent misrepresentation, liability could extend to all foreseeable third parties even absent privity. In this regard, gross negligence could be equated with fraud. A holding of fraud on the basis of gross negligence may be categorized as constructive fraud or fraud in law, as contrasted with fraud in fact.[11]

C. Credit Alliance v. Arthur Anderson and
European American Bank v. Strauhs & Kaye[12]

Another significant case dealing with the liability of accountants and further clarifying New York jurisprudence in this area was the 1985 decision by the Court in *Credit Alliance*, which was a consolidation on appeal of two separate cases.

1. Credit Alliance Case

Credit Alliance Corporation ("Credit") had extended loans to L.B. Smith, Inc. ("Smith") in reliance on financial statements certified by Arthur Andersen & Co. ("Andersen"). Smith defaulted on several million dollars in such loans and filed a petition in bankruptcy. Credit instituted an action against Andersen for damages on its loan losses alleging negligence and fraud by Andersen in that it overstated Smith's assets, net worth and general financial health.

As a first cause of action, the complaint alleged that Andersen knew, should have known or was on notice that the financial statements it prepared for Smith were being used by it to induce companies to make credit available to it. As a second cause of action, the complaint alleged that Andersen knew or recklessly disregarded facts indicating that the financial statements were misleading. However, the allegations in the complaint failed to establish a relationship of contractual privity between Credit and Andersen or a relationship sufficiently intimate to approach that of privity. That is, there was no claim that Andersen was aware beforehand that Credit would be relying on its certification, or that Andersen had any dealing with Credit regarding Smith or its financials. Accordingly, the Court dismissed the first cause of action. The Court also dismissed the second cause of action, which sounded in fraud, because it was comprised only of conclusory allegations.[13]

2. European American Bank Case

Similarly, European American Bank & Trust Company (EAB) had extended loans to Majestic Electro Industries ("Majestic") relying on financial reports prepared by Strauhs and Kaye ("S & K"). Majestic defaulted on the loans and went into bankruptcy, as a result of which EAB suffered substantial losses on the loans. EAB alleged that S & K overstated Majestic's inventory and accounts receivable, among other errors. On its first cause of action, EAB alleged damages on the basis that S&K was negligent in that at all relevant times it knew that EAB was Majestic's principal lender, was familiar with the terms of the lending relationship and was aware that EAB was relying on the financial statements. Furthermore, it was alleged that EAB and a representative of S & K had been in communication, both written and oral, during the lending relationship, and that representatives of EAB and S & K had met frequently to discuss the financial statements. As a second cause of action, EAB alleged that it was damaged because S &K was grossly negligent or recklessly indifferent in performing its professional services.

The Court referred to its earlier decision in *Ultramares*, and its even earlier decision in *Glanzer*, reciting that a relationship " 'so close as to approach that of privity remains valid as the predicate for imposing liability upon accountants to noncontractual parties for the negligent preparation of financial reports.…' "[14] In this regard, the Court set forth certain specific prerequisites that must be satisfied before accountants may be held liable in negligence to noncontractual parties who rely to their detriment on inaccurate financial reports: "(1) the accountants must have been aware that the financial reports were to be used for a particular purpose or purposes; (2) in the furtherance of which a known party or parties was intended to rely; and (3) there must have been some conduct on the part of the accountants linking them to that party or parties, which evinces the accountants' understanding of that party or parties' reliance."[15]

In sharp contrast to the case against Andersen, the facts alleged by EAB clearly showed that S & K was well aware that EAB was the primary and possibly the exclusive user of the financial statements. Most importantly, there was linking conduct since Andersen had been in direct communication with EAB. Consequently, the Court found that the prerequisites for both causes of action were satisfied. It concluded, "that the relationship thus created between the parties was the practical equivalent of privity."[16]

If there was any uncertainty about how far the *Ultramares* rationale extended, the *Credit Alliance* case made it clear that simply being aware of known or foreseeable reliant parties was insufficient to establish liability. The *icing on the cake* required some linking conduct between the reliant party and the alleged tortfeasor.

D. Ossining Union Free School District v. Anderson LaRocca[17]

A few years later, in 1989, the Court of Appeals agreed to hear the *Ossining* case, which involved a claim against professional engineering firms. The facts alleged that the plaintiff school district entered into a contract with the defendant Anderson La Rocca architectural firm to provide an evaluation and feasibility study of the school district's buildings. The contract authorized the Anderson firm to retain consultants. Anderson in turn retained two engineering consulting firms (Thune and Geiger) to test the concrete at various points in the high school annex. They reported serious weakness in the building. It was alleged that Thune and Geiger were aware that their findings would be relied upon by the plaintiffs and that the work was only for the plaintiffs. Furthermore, the engineers sent their bill directly to the school district and there was direct communications between the engineers and the school district. As a result of the engineering report, at substantial expense, the school district closed the annex. A subsequent engineering report by another firm, however, clearly showed that in fact there was nothing wrong with the building and the closing and subsequent expense were unnecessary.

The defendant engineering firms denied liability on the basis of lack of contractual privity, asserting that the only possible exception applied to accountants where there was something akin to privity. They further asserted that only accountants are singled out to go beyond a strict rule of privity because of their central role in the business community. The trial court agreed and dismissed the case and the Appellate Division affirmed.

The Court of Appeals did not agree and reversed. The Court observed that "[w]hether defendants are accountants…or not…such a cause of action requires that the underlying relationship between the parties be one of contract or the bond between them be so close as to be the functional equivalent of contractual privity." Although the Court pointed out that many of the claims involving negligent misrepresentation involve accountants, it noted that it never made a distinction between accountants and other professionals. In the present case, the Court stated that the facts alleged satisfied the criteria in *Credit Alliance*, noted above, namely that: (1) the defendants were aware that the reports were to be used for a particular purpose; (2) there was reliance by a known party in furtherance of the purpose; and (3) there was some conduct linking them to such party and evincing the defendants' understanding of their reliance. Thus, the Court made it clear that the privity doctrine as applied to the accounting profession was not limited to that profession.

E. Prudential Insurance Company v. Dewey, Ballantine et al.[18]

Continuing on with its analysis of the privity doctrine, the Court of Appeals agreed to hear the *Prudential* case, which it decided in 1992. In that case, U.S. Lines, a shipping company, had restructured $92,885,000 of debt with Prudential Insurance Company of America ("Prudential") to be secured by mortgages on ships owned by U.S. Lines. To that end it had asked for an opinion letter from the counsel for U. S. Lines, Gilmartin, Poster & Schaffo ("Gilmartin"), regarding the mortgages. At the request of U.S. Lines, Gilmartin prepared the opinion letter. The letter assured that the mortgage documents, which had been prepared by other counsel (apparently the Dewey, Ballantine law firm), represented "legal, valid and binding" obligations of U.S. Lines. The letter did not mention, however, the amount of the mortgage debt. Prudential accepted the opinion letter as satisfactory and recorded the mortgages. Later, Prudential learned that one of the mortgage documents showed the debt as $92,885 rather than $92,885,000. Consequently, Prudential suffered a significant loss when U.S. Lines filed for bankruptcy and there was a foreclosure sale of ships of U.S. Lines that secured the mortgage. Thereafter, Prudential began a lawsuit against Dewey, Ballantine and Gilmartin. With respect to Gilmartin, Prudential contended that the law firm's opinion letter had falsely assured that the mortgage documents would fully protect its $92,885,000 security interest.

The Supreme Court dismissed the complaint as against Gilmartin and the Appellate Division affirmed based upon the lack of privity between Gilmartin and Prudential.

The Court first referred to its earlier decision in *Ossining* and reaffirmed that there is no reason to arbitrarily limit liability for negligent misrepresentation to accountants only. Concluding that legal professionals are not immune from liability in these type of cases, the Court then considered whether there was either "actual privity" between Gilmartin and Prudential or at least a "relationship so close as to approach that of privity."[19] Since Gilmartin was not in direct privity, the issue therefore was whether there was a relationship close enough to establish liability. The Court referred to its decision in *Credit Alliance* and the other cases referenced in this article and concluded that the criteria set forth in *Credit Alliance* were satisfied: First, Gilmartin was aware that the opinion letter requested by U.S. Lines was to be remitted to Prudential in connection with the debt restructuring; second, Prudential relied on the letter as Gilmartin expected it would; and third, the sending of the letter directly to Prudential created a direct link between the parties. Thus, there was a "bond between Gilmartin and Prudential sufficiently close to establish a duty of care running from the former to the latter."[20]

Nonetheless, in a surprise ending the Court found Gilmartin not liable. Although the Court found that Gilmartin owed Prudential a duty of care, the issue that followed was whether that duty of care was breached. The Court then delved into to the purpose of an opinion letter. In summary, the Court found that the purpose of an opinion letter is to assure that the loan documents are valid, that they comply with the law, that they are enforceable against the buyer and do not violate some other obligation of the borrower. The opinion letter in question, although it did not mention a specific dollar amount, "did fulfill its purpose of assuring procedural regularity.…"[21] The opinion letter stated that the relevant documents were "legal valid and binding" obligations of U.S. Lines, but no dollar amount was assured. Importantly, it had been agreed that the letter would be in a form satisfactory to Prudential. This requirement was satisfied since Prudential accepted the letter as is without any objections to it.

Consequently, although there was duty owed to Prudential by Gilmartin, the Court found that the facts did not prove a breach of that duty, and it thus affirmed the holding of the Appellate Division.

III. THE ACCOUNTANTS ARE WINNERS IN TWO RECENT CASES

It would seem that based upon the number of times the New York Court of Appeals has reviewed the privity doctrine, the state of the law would be quite settled. Nonetheless, the Court of Appeals had occasion to revisit this area of the law in two new decisions, one decided in December, 2000, and another in February, 2001.

A. Harold Tod Parrott v. Coopers & Lybrand[22]

In the *Parrott* case, decided in 2000, the basis of the lawsuit was again negligent misrepresentation. The trial court had denied the motion of Coopers & Lybrand L.L.P. ("Coopers") to dismiss the complaint. The Appellate Division, however, granted the dismissal. The Court of Appeals agreed to hear the matter, and it affirmed.

Harold Parrott ("Parrott") was employed by Pasadena Capital Corporation ("Pasadena"). He had purchased over 40,000 shares of the stock of Pasadena under an agreement providing that upon termination of his employment, the company would buy back the shares at fair market value, to be determined by an independent appraisal conducted in connection with the company's employee stock ownership plan ("ESOP"). In this regard, Coopers had been regularly conducting appraisals of the ESOP. Upon the termination of Parrott's employment, Pasadena exercised its right to buy back its stock, setting a value of $3.9 million based upon Coopers' appraisal done in connection with the ESOP. Subsequently, an arbitration award in favor of Parrott found the value to be about $2.5 million higher. Parrott then instituted an action against Coopers for professional negligence, negligent misrepresentation, and aiding and abetting Pasadena's breach of fiduciary duty.

The Court once again reviewed its prior decisions in this area, specifically referring to the tripartite analysis in *Credit Alliance*. It found, based on this analysis, that the evidence was insufficient to establish a relationship close enough to that of actual privity to sustain liability. Parrott had never met or communicated with Coopers and there was no indication that Coopers knew that its valuation would be used in connection with the stock purchase agreement. Coopers had no awareness that Parrott owned stock in Pasadena or that its stock might be repurchased pursuant to a value that Coopers fixed. Also, Parrott never relied on the valuation numbers supplied by Coopers. In fact, he never read or received Cooper's report; it never was provided to him. From the outset, he rejected Coopers' valuation since he was aware that there was an anticipated sale of Pasadena. Finally, there was no conduct linking Coopers and Parrott. The only indication of a linking – a fact upon which Parrott placed some reliance – was a tenuous statement in Coopers' report that the valuation was performed for "stock transactions involving employees of the Company."[23] Although Parrott was an employee, no evidence was presented that Coopers knew that its valuation would be used for purposes of the stock repurchase.

The Court distinguished its prior holding in White v. Guarente,[24] a case that the plaintiff argued sustained his position. In that case, the accounting firm had contracted with a limited partnership to perform an audit and prepare the partnership's tax returns. The accounting firm was found to have negligently performed the audit and was held liable to the members of the partnership. The nature and purpose of its contract, however, made it perfectly clear that the accounting firm's services were to benefit the members of the partnership who were dependent upon the audit to prepare their own tax returns. The plaintiffs sought redress not as members of the public, but as a particular class of persons to whom the report would be circulated. The accounting firm knew this and it was within the contemplation of its retainer. Thus, in *White*, the Court found that the relationship between the accounting firm and the limited partners was close enough to privity to establish liability.

The Court, referring to its prior decisions, noted that it had previously rejected recovery by any foreseeable reliant party. It also noted that it had rejected an even more restrictive rule that would permit recovery where a specific reliant party was known or foreseen, but where there was no linking conduct with such reliant party.

B. Securities Investor Protection v. BDO Seidman[25]

Procedurally, this case started out in federal District Court, which dismissed the complaint concluding that the plaintiffs had no standing to sue. The United States Court of Appeals for the Second Circuit concluded that plaintiffs lacked standing to sue for third-party customers, but could sue on their own behalf. Two question were certified and accepted for consideration by the New York Court of Appeals.

In this case, Securities Investor Protection Corporation ("SIPC") asserted that BDO Seidman ("BDO") fraudulently or negligently misinformed federal securities regulators about the precarious financial condition of its client, Baron & Co. ("Baron"), a stock brokerage firm that filed for bankruptcy. Thirteen of Baron's employees were convicted of crimes for activities at the firm and Baron itself pleaded guilty to enterprise corruption.

SIPC alleged that there was misappropriation of assets and concealment of growing debt. In its audit report, BDO noted no weakness in Baron's internal controls regarding safeguarding securities. It was also alleged that by failing to perform a proper audit, BDO was able to certify that Baron had a satisfactory net capital. The "net capital rule" requires that a broker's debt not exceed 15 times the amount of liquid capital.[26] It was not until shortly before Baron declared bankruptcy that BDO first reported, in its audit report for 1995, that debt was greater than 15 times capital. The audit report for 1993, however, did report that due to losses there were doubts as to whether Baron could continue as a going concern. And, the audit report for 1994 mentioned an ongoing SEC investigation regarding illegal market manipulation and failure to execute orders, among other matters. The audit reports were all sent to NASD as the regulatory body overseeing Baron's compliance with the securities laws. No audit reports, however, were sent to SIPC by the NASD.

SIPC was created by the Securities Investor Protection Act of 1970.[27] This act was enacted to protect customers of broker-dealers. When a broker-dealer is in financial difficulty, SIPC can petition the courts for protection of the broker's customers, such as by the appointment of a trustee to liquidate the firm and satisfy customer claims. SIPC is also endowed with funds, through assessment of registered brokers. SIPC can advance these funds to a trustee to settle claims. SIPC claimed that it advanced $8 million settling claims and in administrative costs relating to the liquidation of Baron.

SIPC has no independent investigatory power regarding the financial health of its members. It does not receive nor audit financial statements of its members. Further, there is no requirement that brokers submit audited financial statements to SIPC as they are required to submit to the NASD.

In order to bring a protective proceeding, SIPC must first be aware that a broker is in financial difficulty. In this regard, the NASD is required to notify SIPC when a broker is or is approaching financial difficulty. The pleadings in the case did not indicate how SIPC became aware of Baron's problems. Nevertheless, it did institute a protective proceeding and one

James Glidden was appointed trustee to oversee Baron's liquidation. As subrogee to the claims of Baron's customers that it satisfied, and also on its own account for the administrative costs it paid to effect Baron's liquidation, SIPC and Giddens, the trustee, instituted an action against BDO alleging negligence and fraud.

The Second Circuit, as noted, concluded that SIPC and Giddens lacked standing to sue on behalf of Baron's customers, but had standing to sue on its own behalf. In this latter regard, the Second Circuit certified two questions to New York's Court of Appeals concerning New York's law on actions for negligent and fraudulent misrepresentation:

"1. May a plaintiff recover against an accountant for fraudulent misrepresentation made to a third party where the third party did not communicate those misrepresentations to the plaintiff, but where the defendant knew that the third party was required to communicate any negative information to the plaintiff and plaintiff relied to his detriment on the absence of any such communication?"

"2. May a plaintiff recover against an accountant for negligent misrepresentation where the plaintiff had only minimal direct contact with the accountant, but where the transmittal to the plaintiff of any negative information reported was the 'end and aim' of the accountant's performance?"[28]

The Court of Appeals observed that the gravaman of SIPC's claim is that had BDO's audit reports been accurate, it would have learned about Baron's precarious financial situation earlier and could have intervened earlier, thereby avoiding expenditures in connection with the liquidation. SIPC conceded, however, that at no relevant time prior to the liquidation did it receive BDO's audit report. Basically, it relied on the system in place that NASD would advise SIPC of any problem. The Court of Appeals answered both certified questions in the negative.

1. Fraudulent Misrepresentation.

Although SIPC conceded that it never received financial statements from BDO, it understood that silence meant "that BDO had given Baron a clean bill of health." But the Court concluded that "no new is good news" was an insufficient basis to establish liability on the basis of fraud. The Court noted that it was well established under New York law that there must be reliance in an action for fraud. In this case, SIPC "could not claim reliance on alleged misrepresentations of which it was unaware even by implication." [29] The Court did state, however, that it was possible to communicate a misrepresentation through silence, and that a material omission could "induce detrimental reliance as effectively as a false statement."[30] In this case, however, the omission came not from BDO, but from the NASD. SIPC's reliance on silence from NASD regarding Baron's financial situation was not "equated with reliance on any affirmative misrepresentation or concealment of material fact by BDO."[31] The Court thus concluded that "no information at all" could not sustain a claim for fraudulent misrepresentation. The regulatory framework of NASD reporting to SIPC created an "insurmountable disconnect" between BDO's representations and SIPC.[32]

2. Negligent Misrepresentation

The Court dismissed this cause of action without difficulty since there was no "linking conduct" between BDO and SIPC sufficient to establish a relationship under the third prong of the test for liability set forth in *Credit Alliance*. The BDO audit reports were not prepared specifically for SIPC, were not sent to SIPC and were not read by SIPC. Thus, the relationship between BDO and SIPC was not "significantly different from anyone else in the regulatory community or the investing public at large."[33]

IV. OTHER JURISDICTIONS.[34]

Not all jurisdictions follow New York's interpretation of the privity doctrine. Some courts continue to insist on a strict application of privity with respect to accountants, except in cases of special circumstances, such as fraud or gross negligence. On the other hand, a number of jurisdictions have adopted an approach similar to that of New York, or perhaps even more flexible in certain cases, finding liability where there was conduct approaching that of privity. A commonality in such cases is that there was a particular purpose for the accountant's report, a known relying party and some linking conduct. On the other hand, some jurisdictions have adopted an unrestricted foreseeablility rule, while others limit liability to where the reliant party is either known or actually foreseen by the accountant. New York's view is, of course, stricter due to the requirement that there be linking conduct between the parties even where the reliant party is known or foreseen by the accountant

V. CONCLUSION

Since they are a *deep pocket* source of redress, accountants have and no doubt will continue to be a prime target for lawsuits by lenders and investors. Obviously, lawsuits against accountants (and others in the financial community) increase during a bear market such as we have had and arguably still are in. The good new for accountants, however, is that most jurisdictions seemingly do not impose liability to any known or foreseeable plaintiff who might rely on a negligently prepared audit report. Most favorably to accountants, a minority of jurisdictions seem to stick to a strict privity doctrine, except in special circumstances. It seem clear enough, however, that the majority of jurisdictions for the most part follow the standards set forth in *Ultramares* and *Credit Alliance* allowing recovery where there is conduct proximate to though not actual privity. The degree of conduct necessary to find near privity will necessarily depend upon the particular facts and circumstances. In New York at least, it seems clear enough that there must be some minimal direct contact, a linkage, between the reliant party and the accounting firm.

On the other hand, if the complaining party can sustain the much higher burden of proving fraud or gross negligence on the part of the accountant, then arguably the rule is that the accountant should be held liable to any foreseeable party that might rely on its audit report. In this regard, it may be recalled that in *Ultramares* the Court granted a new trial on the cause of action for fraudulent misrepresentation, although it dismissed the cause of action for negligent misrepresentation. Furthermore, as previously pointed out, constructive fraud or fraud in law, as contrasted with fraud in fact, may be sufficient to establish liability.

Finally, at least in New York, the doctrine of privity as applied to accountants has been extended to other professionals.

Footnotes

[1] A landmark case eroding strict privity of contract was MacPherson v. Buick Motor Co., 277 N.Y. 382 (1916), which held a manufacturer liable for negligence though privity was lacking between the manufacturer and user.
[2] Glanzer v. Shepard, 233 NY 236 (1922).
[3] *Id*. at 239.
[4] *Id*. at 238-239.
[5] Ultramares Corporation v. George A. Touche et al., 255 N.Y. 170 (1931).
[6] *Id*. at 183 .
[7] *Id*. at 185.
[8] Courteen Seed Co. v. Hong Kong & Shanghai Banking P. Corp., 245 N.Y. 377 (1927).
[9] Ultramares Corporation v. George A. Touche et al., 255 N.Y. 170, 191 (1931).
[10] *Id*. at 182-183.
[11] Black's Law Dictionary, Fourth Edition.
[12] Credit Alliance Corporation v. Arthur Andersen & Co. and European American Bank and Trust Company v. Strauhs & Kaye et al., 65 N.Y.2d 536 (1985).
[13] Under New York's Civil Practice Law and Rules ("CPLR"), a single allegation of scienter, without additional detail concerning the facts constituting the alleged fraud, is insufficient to maintain such an action. CPLR § 3016(b).
[14] Credit Alliance Corporation v. Arthur Andersen & Co.; European American Bank and Trust Company v. Strauhs & Kaye et al., 65 N.Y.2d 536, 546 (1985).
[15] *Id*. at 551.
[16] *Id*. at 554.
[17] Ossining Union Free School District v. Anderson LaRocca Anderson et al. and Thune Associates Consulting Engineers, 73 N.Y.2d 417 (1989).
[18] Prudential Insurance Company of America v. Dewey, Ballantine, Bushby, Plamer & Wood et al., and Gilmartin, Poster & Schaffo, 80 N.Y.2d 377 (1992).
[19] *Id*. at 382.
[20] *Id*. at 385.
[21] *Id*. at 386.
[22] Harold Tod Parrott v. Coopers & Lybrand, L.L.P., 95 N.Y.2d 479 (2000).
[23] *Id*. at 484.
[24] 43 N.Y.2d 356 (1977).
[25] Securities Investor Protection Corporation and Giddens v. BDO Seidman, LLP, 2001 LEXIS 228 (2001).
[26] *See* 17 CFR § 240.15c3-1.
[27] *See* 15 USC § 78aaa-lll.
[28] Securities Investor Protection Corporation and Giddens v. BDO Seidman, LLP, 2001 LEXIS 228, at *8 (2001).
[29] *Id*. at *10.
[30] *Id*. at *11, citing Gaidon v. Life Ins. Co. of America, 94 N.Y.2d 330 (1999), 448; New York Univ. v. Continental Ins. Co., 87 N.Y.2d. 308 (1995).
[31] Securities Investor Protection Corporation and Giddens v. BDO Seidman, LLP, 2001 LEXIS 228, at *11 (2001).
[32] *Id*. at *13, *14.
[33] *Id*. at *15.

[34] For citations and a review of cases of other jurisdictions, *see* Credit Alliance Corporation v. Arthur Andersen & Co.; European American Bank and Trust Company v. Strauhs & Kaye et al., 65 N.Y. 2d 536, 551-553 (1985). *See also* Rosenblum, Inc. v. Adler, 93 NJ 324 (1983), which illustrates a more liberal standard than that of New York.