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## ACCOUNTANTS' PRIVACY SHIELD: AN ILLINOIS MISTAKE?

Michael J. Polelle\*

### INTRODUCTION

Public Act 84-1251 creates a peculiar standard of liability for accountants sued by third parties for negligent misrepresentation. Its wording resurrects the privity-of-contract defense in a way that raises questions of public policy and state constitutional law. This commentary will explore these problems with Public Act 84-1251 and conclude that, one way or another, it should not be the law in Illinois.

Effective August 6, 1986, Illinois amended its Public Accounting Act<sup>1</sup> to protect public accountants in an unprecedented way. Senate Bill 2108,<sup>2</sup> now Public Act 84-1251,<sup>3</sup> (the "Act") provides accountants with extraordinary protection against negligent misrepresentation actions brought by plaintiffs who are not clients. The amendment initially provides that "no person, partnership or corporation" licensed to practice public accountancy under the Act shall be liable for civil damages to persons "not in privity of contract" unless the conduct of the accountant amounted to intentional fraud or misrepresentation.<sup>4</sup> This portion of the amendment apparently precludes any third party actions based on negligence.

However, subsection 2 of the amendment provides that such persons, partnerships, or corporations are also liable to non-privity plaintiffs if the public accountant was aware that "a primary intent of the client was for the professional services to benefit or influence the particular person bringing the action . . . ." <sup>5</sup> Given this language, it appears that if a client tells his accountant that an audit, balance sheet, or other financial document prepared by the accountant is to be used by the client to obtain a loan from a specific

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1. Illinois Public Accounting Act, P.A. 83-291, § 1 (effective Sept. 14, 1983) (codified at ILL. REV. STAT. ch. 111, paras. 5500.1 to 5536 (1987)). The Illinois Public Accounting Act was originally chapter 110 1/2 of the Illinois Revised Statutes. The Act was transferred to chapter 111 which was established under a program to improve the utility of Illinois statutes. Chapter 111 also includes provisions regulating other professions.

2. S. 2108, 84th Illinois Gen. Assembly (introduced Apr. 11, 1986).

3. P.A. 84-1251, § 1 (effective Aug. 6, 1986) (codified at ILL. REV. STAT. ch 111, para. 5535.1 (1987)).

4. *Id.*

5. *Id.*

bank, the public accountant will be liable to the bank for any negligent misrepresentation made in the document which the bank relies on in extending the loan. Therefore, this first clause of subsection 2 apparently allows for third party actions based on negligence, provided the accountant has knowledge of the third party's reliance. This much of the provision, as will be shown, is neither surprising nor objectionable.

The latter part of subsection 2, however, provides a unique twist. The second clause contains the following proviso regarding the accountant's liability toward parties not in contractual privity who sue on the grounds of negligent misrepresentation, or indeed for any civil action other than intentional fraud:

[I]f such person, partnership or corporation (i) identifies in writing to the client those persons who are intended to rely on the services, and (ii) sends a copy of such writing or similar statement to those persons identified in the writing or statement, then such person, partnership or corporation or any of its employees, partners, members, officers or shareholders may be held liable only to such persons intended to so rely, in addition to those persons in privity of contract with such person, partnership or corporation.<sup>6</sup>

The effect worked by this proviso is remarkable. While the first part of subsection 2 provides redress for a third party injured by an accountant's negligent misrepresentation if the accountant knew the statement would be used to influence the third party, the second part of subsection 2 conditions this protection on the accountant notifying the interested parties in writing. This additional language effectively removes the protection granted in the earlier portion of the subsection.

For example, let us again assume that a client tells his accountant that she will use a financial statement prepared by the accountant to obtain a loan from a specific bank. Let us assume further that the accountant even acknowledges, orally or in writing, his understanding that a specific bank is relying on the accuracy of the statement. That accountant cannot be held liable for whatever harm is caused by the bank's reliance on the negligently prepared statement provided the misrepresentation does not amount to intentional fraud, or the accountant does not identify the third party in writing and does not mail a copy of this written identification to both the client and the bank. The accountant avoids liability even though the client, the accountant, and the bank know that a third party intends to rely on the statement, the identity of that third party, and the reason for the third party's reliance.

Thus, the proviso makes it effectively impossible for any person not in privity of contract to sue the public accountant for negligent misrepresentation. The proviso mysteriously gives the accountant, and not the client, the right to prepare the writing which identifies the third parties who will rely on the statement. It is peculiar that before liability attaches to the

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6. *Id.*

accountant, the accountant must notify the client of what the client already knows—the identity of the third party whom the client intends to influence with the statement—and must further send a copy of this written identification of the third party to the third party. Presumably, the third party, a bank or lender, for instance, knows not only its own identity but the fact that it is relying on documents prepared by the accountant. Clearly, the structure of the proviso produces arbitrary and unfair results.

Even if one wishes to protect accountants from third party liability, the expectation would normally be that the client, and not the accountant, would determine the scope of liability. By notifying the accountant that a particular third party was relying on the accuracy of the financial statement, the client would provide the accountant with fair warning and the third party with a degree of protection. Under the present wording of the proviso, however, it is the accountant who is in absolute control of the scope of his liability. The accountant obviously has no incentive to prepare a written list of third parties with whom he is not in privity and to communicate that list to the client so that these third parties may then sue him or her for negligent misrepresentation. Even if the public accountant were so heedless of self-interest in preparing and sending such a written notification to the client, the accountant is still protected under the amendment so long as he remembers not to mail a copy of this document to the third parties themselves.

This right of the accountant, rather than the client, to determine the scope of his liability with regard to non-privity third parties is so bizarre and departs so drastically from Anglo-American legal development<sup>7</sup> that only two conclusions seem plausible. First, the wording of the proviso may simply be a mistake in drafting caused by legislative pressures. Second, the language may represent the fine hand of the drafter in uniquely protecting Illinois accountants from all non-privity third party claims, other than those based on deceit. But regardless of which explanation is the correct one, the fact remains that privity of contract has been resurrected, without fanfare, from its legal grave to protect accountants from tort claims in Illinois.

## I. BACKGROUND

### A. *Legislative History*

The legislative history of Senate Bill 2108 does not reveal the reason for the wording of the statutory amendment. The original wording of this amendment to the Illinois Public Accounting Act literally limited the liability of public accountants for negligent misrepresentation to those with whom the accountants were in privity of contract.<sup>8</sup> Senate Bill 2108 was subsequently

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7. See *infra* notes 16-42 and accompanying text (setting forth common law approaches to accountants' liability for negligent misrepresentation).

8. SENATE JOURNAL OF ILLINOIS at 845 (May 14, 1986).

amended in the House by Amendment No. 4. House Amendment No. 4 originally provided that a public accountant would be liable "to a third party who relies on such professional services, and then, only if notice of the intent to so rely is provided to the person, partnership or corporation, licensed or authorized to practice under this Act at or before the time the contract is entered into . . . ." Note that this original version required that the accountant be provided with, and not provide, the notice that a specific party would rely on the statement.

However, when Senate Bill 2108 emerged from a joint conference committee of the House and Senate, formed to achieve a compromise in the wording of the bill, a curious thing happened. House Amendment No. 4 was reworked into its current version which places the power to defeat the claim of a relying non-privity party in the hands of the accountant.<sup>10</sup> The rewording of House Amendment No. 4 effectively destroyed any legal responsibility public accountants had toward third parties, even where the accountant actually knows that the third parties are relying on the accuracy of the accountant's statements. The imposition of limited legal responsibility was precisely what House Amendment No. 4 sought to accomplish in its original version.<sup>11</sup> Instead, what emerged from the joint conference committee was a final version of the bill that in a roundabout way accomplished what the original version of Senate Bill 2108 sought to achieve: the limitation of an accountant's responsibility for negligent misrepresentations to those in privity of contract with the accountant.<sup>12</sup> In effect, the "compromise" between the House and the Senate resulted in the enactment of the original view of the Senate sponsors.

Representative Countryman was the only member of the House who, during debate, noted and objected to the incongruity in the joint conference committee proposal. The proposal excluded from coverage the very people the House was trying to protect in its original amendment to the bill—third parties specifically known by the accountant to be relying on statements prepared by the accountant.<sup>13</sup> If such a party relies to his detriment on a

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9. HOUSE JOURNAL OF ILLINOIS at 2785 (June 19, 1986).

10. *Id.* at 4794 (July 1, 1986).

11. *Id.* at 2785 (June 19, 1986).

12. S. 2108, 84th Illinois Gen. Assembly (introduced Apr. 11, 1986). The bill as originally drafted provided:

No certified public accountant, either individually or as a member of a partnership or an officer of a corporation as provided in Section 8 of this Act, shall be liable, to persons not in privity of contract with such certified public accountant who rely on the work product of such certified public accountant, for civil damages resulting from the certified public accountant's acts, decisions or other conduct in connection with his duties, except for such acts, decisions or conduct involving wilful or wanton misconduct.

*Id.*

13. ILLINOIS HOUSE OF REPRESENTATIVES DEBATE, 84th Illinois Gen. Assembly at 41 (July 1, 1986).

negligently prepared statement, he will have no legal recourse except in the unlikely event an accountant is prepared to expand the scope of his liability through the written notifications specified by the final version of the bill.<sup>14</sup> In opposing this final version, Representative Countryman prophetically noted that its wording "tells us pretty much what the accountants want us to do and that is to put the thing in the merry-go-round so it becomes so confusing nobody really knows what's happening, including the accountants."<sup>15</sup>

### B. Non-Illinois Case Law

To understand the radical change affected by Public Act 84-1251 one must examine the common law as it now exists across the country. There are currently four major approaches used by the courts in determining the scope of an accountant's common law duty for negligent misstatements relied on by parties not in contractual privity with the accountant.

The most restrictive view of an accountant's liability is that employed by the state of New York. That approach purports to follow the view of Justice Cardozo in the classic case of *Ultramares Corp. v. Touche, Niven & Co.*<sup>16</sup> Under the New York courts' reinterpretation of *Ultramares*, an accountant can be held liable for negligent misrepresentations to noncontractual parties only if three conditions are met: 1) the accountant must have known that the financial statement was to be used for a particular purpose or purposes; 2) the accountant must have known that a particular party was intending to rely on the statement; and, 3) the accountant must have engaged in some conduct linking the accountant to the known party and which shows the accountant's understanding of that party's reliance on the accountant's work.<sup>17</sup> Thus the original version of House Amendment No. 4 to Senate Bill 2108 was analogous to the New York approach.<sup>18</sup>

The second view, which follows the Restatement (Second) of Torts, section 552, is somewhat less restrictive.<sup>19</sup> Under this view, a defendant who in the

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14. ILL. REV. STAT. ch. 111, para. 5535.1(2) (1987).

15. ILLINOIS HOUSE OF REPRESENTATIVES DEBATE, 84th Illinois Gen. Assembly at 43-44 (July 1, 1986).

16. 255 N.Y. 170, 174 N.E. 441 (1931).

17. *Credit Alliance v. Arthur Anderson & Co.*, 65 N.Y.2d 536, 551, 483 N.E.2d 110, 118, 493 N.Y.S.2d 435, 443 (1985).

18. The original version of House Amendment No. 4 to Senate Bill 2108 embodies two of the requirements of *Ultramares*. The accountant was to be held liable "to a third party who relies on such professional services, and then, only if notice of the intent to so rely is provided to the person, partnership or corporation, licensed or authorized to practice under this Act at or before the time the contract is entered into . . . ." HOUSE JOURNAL OF ILLINOIS at 2785 (June 19, 1986). This section required that the accountant know, prior to the preparation of the statement, that the statement was to be used for a particular purpose and that the accountant know of the particular party who was to rely on the statement.

19. RESTATEMENT (SECOND) OF TORTS § 552 (1977). Section 552 provides:

(1) One who, in the course of his business, profession or employment, or in any

course of his business, profession, employment, or other pecuniary transaction negligently supplies false information for use by others in their business affairs is subject to liability for the negligent misrepresentation.<sup>20</sup> However, this duty is owed only to plaintiffs who belong to a limited group of persons known to the defendant and whom the defendant intends to influence.<sup>21</sup> The Restatement (Second) approach differs from the New York view because the defendant does not have to know the specific identity of a particular plaintiff but only the identity of a limited group who would rely on the information. A variation of the Restatement (Second) view was recognized by the Illinois courts before the passage of Public Act 84-1251.<sup>22</sup>

A third and even more liberal view is that embodied in the "balancing" approach. Under this view, first created by the California Supreme Court<sup>23</sup> and subsequently adopted in Missouri,<sup>24</sup> the decision whether to create a duty to non-privity parties for negligent misrepresentation depends on the weighing of various factors.<sup>25</sup> These factors include the degree to which the transaction is intended to affect the third party, the foreseeability of harm, the closeness of the link between defendant's conduct and the harm, the moral blame accruing to defendant's conduct, and the need to deter future harm.<sup>26</sup>

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other 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 a limited group of 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 that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.

(3) The liability of one who is under a public duty to give the information extends to loss suffered by any of the class of persons for whose benefit the duty is created, in any of the transactions in which it is intended to protect them.

*Id.*

20. *See id.* § 552(1).

21. *Id.* § 552(2)(a)-(b). *See also* Raritan River Steel Co. v. Cherry, Bekaert & Holland, 322 N.C. 200, 367 S.E.2d 609, 614 (1988) (construing § 552).

22. *See infra* notes 30-56 and accompanying text for the development of Illinois' common law approach to accountant liability for negligent misrepresentation and a discussion of its similarity to the Restatement (Second) approach. *See also infra* notes 62-64 and accompanying text for a discussion of how the Restatement (Second) approach has been used to govern other Illinois professions as well.

23. *Biakanja v. Irving*, 49 Cal. 2d 647, 320 P.2d 16 (1958).

24. *Aluma Kraft Mfg. Co. v. Elmer Fox & Co.*, 493 S.W.2d 38 (Mo. Ct. App. 1973).

25. *Biakanja*, 49 Cal. 2d at 650, 320 P.2d at 19.

26. *Id.*

Finally, the approach which results in the most expansive scope of duty simply adopts the standard test for determining the scope of duty in negligence cases. Under this view, the accountant owes a duty to all persons whom the accountant should reasonably foresee would receive the financial statements prepared by the accountant and thereafter rely on such statements.<sup>27</sup> Wisconsin, New Jersey, and one California appellate case have adopted this view.<sup>28</sup> This foreseeability test was originally developed by Justice Cardozo as the standard scope of duty test in negligence cases.<sup>29</sup>

### C. *The Common Law Approach in Illinois*

#### 1. *State Cases*

In 1969, the Illinois Supreme Court, in *Rozny v. Marnul*,<sup>30</sup> recognized for the first time that a non-privacy party could bring an action in Illinois for negligent misrepresentation.<sup>31</sup> Such parties were no longer limited to actions for intentional fraud. In *Rozny*, a surveyor who was working under a contract to a builder, prepared a plat plan which contained inaccurate descriptions of the land which was purchased by homeowners. The court held that the surveyor owed a duty to the ultimate home purchasers for the negligently prepared plat. The Illinois Supreme Court listed a number of factors which influenced its decision: the knowledge that a limited group of home purchasers would rely on the plat; the guarantee of accuracy on the plat; the deterrent effect of holding the surveyor liable; the absence of proof that corrected copies of the plat were ever delivered; and the undesirability of allowing an innocent party to bear the burden of the surveyor's mistakes.<sup>32</sup> The Illinois Supreme Court subsequently provided a summary of current developments regarding intentional, negligent, and innocent misrepresentation in *Moorman Mfg. Co. v. National Tank Co.*<sup>33</sup> The *Moorman* court cited *Rozny* and stated that one who is in the business of supplying infor-

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27. *International Mortgage Co. v. John P. Butler Accountancy Corp.*, 177 Cal. App. 3d 806, 820, 223 Cal. Rptr. 218, 227 (1986) (duty of care owed to reasonably foreseeable plaintiff who relies on negligently prepared financial statement); *Rosenblum v. Adler*, 93 N.J. 324, 352, 461 A.2d 138, 153 (1983) (when individual auditor furnishes opinion with no limitation in certification as to whom statements may be disseminated, duty arises as to those parties who could be reasonably foreseen as recipients); *Citizens State Bank v. Timm, Schmidt & Co.*, 113 Wis. 2d 376, 386, 335 N.W.2d 361, 366 (1983) (accountant's liability to third parties determined under acceptable principles of negligence law).

28. See *supra* note 27 (citing cases).

29. *Palsgraf v. Long Island R.R.*, 248 N.Y. 339, 162 N.E. 99 (1928) (liability for negligent act will lie where possibility that the act would cause resulting harm was in range of "reasonable apprehension").

30. 43 Ill. 2d 54, 250 N.E.2d 656 (1969).

31. *Id.* at 68, 250 N.E.2d at 663 ("tort liability will henceforth be measured by the scope of the duty owed rather than the artificial concepts of privity").

32. *Id.* at 67-68, 250 N.E.2d at 663.

33. 91 Ill. 2d 69, 435 N.E.2d 443 (1982).



mation to guide others in their business transactions may be held liable for negligent misrepresentations.<sup>34</sup>

It is the Illinois Appellate Court, however, that has been left to apply the principles articulated in *Rozny* and *Moorman* to accountants. In *Brumley v. Touche, Ross & Co. (Brumley I)*,<sup>35</sup> the appellate court, after surveying the law in other jurisdictions, concluded that a public accountant had a duty to third persons who relied on a document which was negligently prepared by the accountant, provided the accountant was acting at the direction of his client, or on behalf of his client, to benefit or influence the third party with the document.<sup>36</sup> In applying this test, the appellate court in *Brumley I* affirmed the dismissal of the amended complaint because the plaintiff investor had only alleged that the public accounting firm should have foreseen reliance on the audit by a class of investors interested in purchasing the client's business.<sup>37</sup> The complaint failed to specifically allege that the public accounting firm knew of the plaintiff or that the audit was to be primarily used by the accounting firm's client to influence the plaintiff investor.<sup>38</sup>

However, in *Brumley II*,<sup>39</sup> the same court found that the plaintiff investor had made the proper allegations in the third amended complaint.<sup>40</sup> The *Brumley II* court noted the key allegations sufficient to state a cause of negligent misrepresentation against the accountant:

Plaintiff also alleged that he advised Touche, Ross [defendant] of his interest in acquiring KPK stock and that the reports prepared by defendant had been submitted to plaintiff for the purpose of influencing his stock purchase decision. The complaint further alleged Touche, Ross knew he was using the reports to formulate an offer for the stock and that defendant confirmed to plaintiff that its auditing report accurately reflected the financial position of its client KPK.<sup>41</sup>

It was also made clear in both *Brumley I* and *Brumley II* that the Illinois Appellate Court intended to use the very same test for accountants that the Illinois Supreme Court had developed for defendant lawyers who are sued by those not in privity of contract with them.<sup>42</sup>

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34. *Id.* at 88-89, 435 N.E.2d at 452 ("economic loss is recoverable . . . where one who is in the business of supplying information for the guidance of others in their business transactions makes negligent representations.").

35. *Brumley v. Touche, Ross & Co.*, 123 Ill. App. 3d 636, 463 N.E.2d 195 (1984) (*Brumley I*).

36. *Id.* at 642, 463 N.E.2d at 200.

37. *Id.*

38. *Id.*

39. *Brumley v. Touche, Ross & Co.*, 139 Ill. App. 3d 831, 487 N.E.2d 641 (1985) (*Brumley II*).

40. *Id.* at 836, 487 N.E.2d at 645.

41. *Id.*

42. *Brumley I*, 123 Ill. App. 3d 636, 642, 463 N.E.2d 195, 200 (1984); *Brumley II*, 139 Ill. App. 3d 831, 835, 487 N.E.2d 641, 644 (1985) (citing *Brumley I* as having sought to pattern duty of accountant after duty imposed upon attorney with regard to non-privity suits based on negligence).

## 2. Federal Decisions

Illinois federal district courts have shed further light on the Illinois common law approach by applying *Brumley I* and *Brumley II* to new situations. In *Gutfreund v. Christoph*,<sup>43</sup> for example, seventeen investors sued an accounting firm for violating federal statutory law and brought a pendent claim of negligent misrepresentation under Illinois law. The plaintiffs alleged that the accountants misrepresented the economic viability of a dairy farm.<sup>44</sup> Although the investors were not in privity with the defendant accounting firm, the federal district court found that unlike the situation in *Brumley I*, the public accounting firm in *Gutfreund* made its economic projections at the behest of its clients to influence prospective dairy farm investors.<sup>45</sup> Such projections were made primarily, if not exclusively, for the purpose of influencing those investors.<sup>46</sup> The *Gutfreund* court reasoned:

This is not at all like a garden-variety annual certification of financial statements to a company's Board of Directors, which then chooses to use those statements to promote a scheme of its own. On the contrary, [the accounting firm's] development of the projections for the farm had as its present goal the inducement of investors to buy partnership interest in Fox Briar. Plaintiffs' negligent misrepresentation claims survive.<sup>47</sup>

Similar to *Gutfreund*, *Frymire v. Peat, Marwick, Mitchell & Co.*<sup>48</sup> also involved a pendent state claim for negligent misrepresentation that was governed by Illinois law. Unlike *Gutfreund*, however, the federal district judge in *Frymire* concluded that although the defendant accounting firm had expressly allowed its client to use financial statements prepared by the firm in the client's annual reports, the accounting firm owed no duty to investor plaintiffs who had relied on such statements.<sup>49</sup> The court reasoned that the complaint did not allege that the client company specifically directed the accounting firm to prepare a financial statement for the express purpose of luring investors.<sup>50</sup>

The *Frymire* court then went even further in justifying its conclusion. The court distinguished *Brumley II* by noting that only one major investor was seeking control of a company in that case,<sup>51</sup> whereas the case before the court involved a class of unspecified investors and, therefore, did not satisfy the limitation announced by the Illinois Supreme Court in *Rozny v. Marnul*.<sup>52</sup> In *Rozny*, the Illinois Supreme Court had stated that the fact that the class

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43. 658 F. Supp. 1378 (N.D. Ill. 1987).

44. *Id.* at 1380-81.

45. *Id.* at 1394.

46. *Id.*

47. *Id.* at 1394-95.

48. 657 F. Supp. 889 (N.D. Ill. 1987).

49. *Id.* at 897.

50. *Id.* at 898-99.

51. *Id.*

52. 43 Ill. 2d 54, 66-67, 250 N.E.2d 656, 662-63 (1969).

of potential plaintiffs was "restricted to a comparatively small group" was relevant to the determination.<sup>53</sup> Accordingly, the *Frymire* court concluded: "While Illinois law will impose a duty on auditors which extends beyond their immediate client in some situations, the scope of that duty is not broad and it does not extend to investors in general as plaintiffs allege."<sup>54</sup>

In short, the federal district court applications of *Brumley I* and *Brumley II*, as limited by the broader guidelines set by the Illinois Supreme Court in *Rozny* and *Moorman*, indicate that Illinois common law approach to accountant liability is quite similar to the approach taken by the Restatement (Second) of Torts, section 552. The *Brumley* courts' requirement that the accountant have knowledge of the third party's reliance on the document is explicit in the Restatement (Second). The *Rozny* court approvingly cited the tentative draft of section 552, requiring that the group relying on the statement be limited rather than general in nature and number.<sup>55</sup> The *Moorman* court's focus on plaintiffs who are engaged in the business of supplying information to another is also consistent with the pecuniary limitations of the Restatement.<sup>56</sup>

### III. ANALYSIS

#### A. *The Lack of a Rational Justification for Public Act 84-1251*

A survey of common law development outside Illinois demonstrates that as a result of the Illinois privity-shield amendment for public accountants, Illinois is not only out of the mainstream of legal development, but out of the stream itself. None of the four major common law approaches reviewed in the previous section even hints at the virtual veto over liability which, under the Illinois amendment, is given to the very group who is to be regulated. The new legislation, perhaps unwittingly, perhaps not, would even make it impossible to enforce the rights of a third party beneficiary who was specifically intended to benefit from the contract between client and accountant.<sup>57</sup> Even in this situation, if the accountant chose not to comply with the written identification requirements of Public Act 84-1251, liability would not be imposed.

In contrast, the Kansas legislature recently enacted a statute which holds

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53. *Id.* at 67, 250 N.E.2d at 663.

54. *Frymire*, 657 F. Supp. at 899.

55. 43 Ill. 2d at 66-67, 250 N.E.2d at 662-63.

56. See *supra* note 19 (Restatement (Second) requires that supplier of information be engaged in a course of business or some transaction in which he has a pecuniary interest).

57. For a discussion of the difference between parties to a contract in "privity" and third party beneficiaries, see *Wilde v. First Fed. Sav. & Loan Ass'n*, 134 Ill. App. 3d 722, 731, 480 N.E.2d 1236, 1242 (1985) (one in privity is actual party to contract whereas third party beneficiary is one whom contract is intended to benefit although not actual party (citing *Sabath v. Mansfield*, 60 Ill. App. 3d 1008, 1016, 377 N.E.2d 161, 168-69 (1978))).

an accountant liable if:

- (1) the defendant knew at the time of the engagement or the defendant and the client mutually agreed after the time of the engagement that the professional accounting services rendered to the client would be made available to the plaintiff, who was identified in writing to the defendant; and
- (2) the defendant knew that the plaintiff intended to rely upon the professional services rendered the client in connection with specified transactions described in writing.<sup>58</sup>

Although Kansas also requires a written notification of third party identity, it is the client who notifies the accountant of that identity and not the other way around as in the Illinois legislation.

In fact, not even the model bill prepared by the American Institute of Certified Public Accountants gives control over the scope of liability to the accountant.<sup>59</sup> Rather, like the Kansas statute, this model bill turns on whether the plaintiff third party was specifically identified to the defendant accountant.<sup>60</sup> The model bill does not even require that the accountant be notified in writing.<sup>61</sup> It is paradoxical that Illinois provides public accountants with greater protection than that recommended in a model bill designed by a national association of accountants.

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58. KAN. STAT. ANN. § 1-402(b)(1)-(2) (Supp. 1987).

59. A STATUTE FOR A PRIVACY REQUIREMENT IN SUITS FOR NEGLIGENT PERFORMANCE OF ACCOUNTING SERVICES (Am. Inst. of Certified Pub. Accountants 1986). The text of the statute reads as follows:

I. Applicability of Chapter—Suits for Negligent Performance of Accounting Services

(a) This chapter applies to all causes of action of the type specified herein filed on or after the effective date.

(b) This chapter governs any action based on negligence brought against any accountant or firm of accountants registered, licensed or practicing in this state by any person or entity claiming to have been injured as a result of financial statements or other information examined, compiled, reviewed, certified, audited or otherwise reported or opined on by the defendant accountant.

II. Requirement of Privity

No action covered by this chapter may be brought in any court in this state unless:

(a) The plaintiff (1) is the issuer (or successor of the issuer) of the financial statements or other information examined, compiled, reviewed, certified, audited or otherwise reported or opined on by the defendant accountant and (2) engaged the defendant accountant to examine, compile, review, certify, audit or otherwise report or render an opinion on such financial statements; or

(b) The defendant accountant: (1) was aware at the time the engagement was undertaken that the financial statements were to be made available for use in connection with a specified transaction by the plaintiff who was specifically identified to the defendant accountant, (2) was aware that the plaintiff intended to rely upon such financial statements in connection with such specified transaction, and (3) had direct contact and communication with the plaintiff and expressed by words or conduct the defendant accountant's understanding of the plaintiff's reliance on such financial statements or other information.

60. See *supra* note 59.

61. *Id.*

In addition, the Illinois amendment departs from the trends in Illinois common law regarding actions for negligent misrepresentation to third parties not in privity. Illinois courts have applied a version of the Restatement (Second) of Torts to impose this kind of liability for every professional group engaged in the enterprise of supplying information for the guidance of others.<sup>62</sup> Nonetheless, the Illinois General Assembly in Public Act 84-1251 exempted only public accountants from this orderly growth of common law liability. Surveyors remain liable for negligent misrepresentations to third parties even if they do not prepare and mail a list of such parties.<sup>63</sup> Similarly, lawyers and termite inspectors are subject to the same liability.<sup>64</sup> The discriminatory nature of the amendment is apparent in the fact that it provides unique protection for the accounting profession. Although every Illinois case which has considered the problem has determined that, in principle, the same law that applies to lawyers should apply to accountants.

There is no adequate justification for this special back-to-privity protection for accountants. First, at the time of the *Ultramares*<sup>65</sup> decision by Justice Cardozo, the accounting profession was arguably a fledgling profession needing judicial protection due to the lack of malpractice insurance protection. Now, however, malpractice insurance appears to be available at reasonable costs in relation to professional income and none of the cases indicates any kind of malpractice insurance crisis comparable to that alleged to exist in the medical profession.<sup>66</sup> Economic justifications, therefore, are inadequate.

Second, there is no lack of a fair legal standard by which to determine whether an accountant has acted negligently. Public accounting firms have developed the generally accepted principles of accounting that provide judges with adequate standards by which to determine negligence.

Third, accountants are often the best cost-avoiders because they are better able to pass on the cost of the harm to society than is the client.<sup>67</sup> The client is often bankrupt or judgment-proof. The client's insolvency is usually why the accountant is sued in the first place. Furthermore, even if the client is solvent, individual investors and small businesses are not as capable of absorbing the loss or passing it on in the form of higher prices as are the increasingly larger and more complex public accounting firms.

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62. See *infra* notes 63-64 and accompanying text.

63. *Rozny v. Marnul*, 43 Ill. 2d 54, 250 N.E.2d 656 (1969).

64. *Ogle v. Fuiten*, 102 Ill. 2d 356, 466 N.E.2d 224 (1984) (lawyer); *Perschall v. Raney*, 137 Ill. App. 3d 978, 484 N.E.2d 1286 (1987) (termite inspector).

65. 255 N.Y. 170, 174 N.E. 441 (1931).

66. *Rosenblum v. Adler*, 93 N.J. 324, 349 & n.11, 461 A.2d 138, 151 & n.11 (1983) (citing 1976 survey by the Practising Law Institute which found that accounting firms had little difficulty in obtaining insurance at reasonable cost).

67. *International Mortgage Co. v. John P. Butler Accountancy Corp.*, 177 Cal. App. 3d 806, 820, 223 Cal. Rptr. 218, 227 (1986) ("risk of such loss is more appropriately placed on the accounting profession which is better able to pass such risk to its customers and the ultimate consuming public.").

Fourth, the courts have suggested that, even without malpractice insurance coverage, accountants can protect themselves from liability and at the same time give fair warning to third parties by expressly disclaiming in their accounting statements any intent that third parties should rely on the statements.<sup>68</sup> The accountant's failure to make this disclaimer reflects a desire to reap the good will and confidence of an unsuspecting third party while assuming no risk. It is legally perverse to hold that an unrestricted guarantee of accuracy on a survey is a factor that can be used to impose third party liability on a surveyor but that same unrestricted statement cannot be used to impose liability on an accountant. If the certification proves inaccurate, the accountant reaps the benefit of the unrestricted certification without fully bearing the cost.

Finally, in what was a doctrinally questionable distinction to begin with, Public Act 84-1251 widens the disparity in legal treatment between the scope of duty applied where a product is at issue and the scope of duty applied in cases involving defective information. The basic justification for this disparity is the fear of the development of unlimited liability to an unlimited group for an unlimited time where information is involved.<sup>69</sup> However, this concern applies with equal force to product liability. Additionally, this concern can, to the extent it remains valid, be addressed by appropriate statutes of limitation or repose. Notwithstanding, the law continues to insist that information flow deserves more protection than product flow.<sup>70</sup>

But, even if one assigns a greater social utility to negligent information than to a negligent product, the distinction is basically artificial. This is so because underneath every negligent misrepresentation a diligent lawyer can usually find a negligent act or omission. If a standard negligence analysis, incorporating the foreseeability factor, were applied to the same factual scenario, the actor would often be subject to liability anyway. For example, in the classic case of *Glanzer v. Shepard*<sup>71</sup> a public weigher was held liable for negligently misrepresenting the weight of beans purchased by a plaintiff who was not in privity with the public weigher. The foundation for that negligent misrepresentation was probably a negligent act in the physical weighing of the beans. That negligent act was no different than the careless

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68. *Rosenblum*, 93 N.J. at 351, 461 A.2d at 152 ("auditors could in some circumstances . . . expressly limit in their certificates the persons or class of persons who would be entitled to rely on the audit"). See generally Stanton & Dugdale, *Recent Developments in Professional Negligence—II: Accountant's Liability to Third Parties*, 132 NEW L.J. 4, 5 (1982) (discussing English court's view of disclaimers in accountant's statements).

69. *Ultramares*, 255 N.Y. at 179, 174 N.E. at 444 ("[i]f 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").

70. *Greycas, Inc. v. Proud*, 826 F.2d 1560, 1564 (7th Cir. 1987) (many producers of information have difficulty reaping financial benefit from society because property rights system with regard to information is incomplete; law must be careful not to impose too heavy a burden on producers or underproduction of information or ideas will result).

71. 233 N.Y. 236, 135 N.E. 275 (1922) (opinion by Cardozo, J.).

driving of a car. Yet Illinois Public Act 84-1251 even forecloses this last-resort avenue of liability because the act immunizes the accountant not only for misrepresentations but also for the "acts, omissions, decisions or other conduct"<sup>72</sup> that were the cause of the misrepresentation.

*B. A Possible Constitutional Problem With Public Act 84-1251*

The lack of wisdom in passing Public Act 84-1251 may have even broader ramifications than simply providing a good reason for repeal of the law. A strong case can be made that this legislation violates article IV, section 13 of the Illinois Constitution.<sup>73</sup> Section 13 prohibits the General Assembly from passing a special law whenever a general law is or can be made applicable, according to judicial determination.<sup>74</sup> The Illinois Supreme Court has observed that laws which confer a special or exclusive benefit on a group without a sound rational basis for doing so are particularly vulnerable to attack under this provision.<sup>75</sup>

In several cases, the Illinois Supreme Court has specifically applied this constitutional principle to laws benefitting one profession or occupation over another.<sup>76</sup> Two cases are particularly relevant to the constitutionality of

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72. ILL. REV. STAT. ch. 111, para. 5535.1(1) (1987).

73. ILL. CONST. art. IV, § 13. For a discussion assessing the validity of Public Act 84-1251 under the "Right to a Remedy and Justice" clause, art. I, § 12, of the Illinois Constitution, see Henry, *Limiting Accountants' Liability to Third Parties: A Review*, 77 ILL. B.J. 322, 326 (1989). Professor Henry, however, concludes that the argument for unconstitutionality under art. I, § 12 is weak. *Id.*

74. The text reads as follows: "The General Assembly shall pass no special or local law when a general law is or can be made applicable. Whether a general law is or can be made applicable shall be a matter for judicial determination." ILL. CONST. art. IV, § 13. See also *Gaca v. City of Chicago*, 411 Ill. 146, 103 N.E.2d 617 (1952) (purpose of constitutional section prohibiting special laws was to prevent granting of privileges to one or more persons while impairing rights of others). See generally Turkington, *Equal Protection of the Laws in Illinois*, 25 DEPAUL L. REV. 385 (1976) (discussing history of art. IV, § 13 and comparing the analysis under it with analyses under federal and Illinois equal protection clauses).

75. See, e.g., *Illinois Polygraph Soc'y v. Pellicano*, 83 Ill. 2d 130, 137-38, 414 N.E.2d 458, 462 (1980) (upholding legislation providing for the licensing of lie-detector operators). The *Pellicano* court defined the test under § 13 as follows: "Special legislation confers a special benefit or exclusive privilege on a person or a group of persons to the exclusion of others similarly situated. It arbitrarily, and without a sound, reasonable basis, discriminates *in favor* of a select group." *Id.*

The Illinois Supreme Court has also noted that the language in art. IV, § 13, explicitly giving the judiciary power to enforce the provision, "has increased judicial responsibility for determining whether a general law 'is or can be made applicable.'" See, e.g., *Grace v. Howlett*, 51 Ill. 2d 478, 487, 283 N.E.2d 474, 479 (1972) (striking down under art. IV, § 13 provisions of no-fault automobile insurance statute, which placed statutory cap on damages recoverable in any auto accidents resulting in less than death, but only extended mandatory minimum insurance requirement to policies protecting "private passenger automobiles").

76. See, e.g., *Jenkins v. Wu*, 102 Ill. 2d 468, 468 N.E.2d 1162 (1984) (upholding exemption in statute—which ordinarily made any medical information obtained by board strictly confidential—solely for physicians whose staff privileges are being challenged); *Anderson v. Wagner*,

Public Act 84-1251. In *Skinner v. Anderson*,<sup>77</sup> the state high court struck down as violative of article IV, section 13 a legislative attempt to create a special four-year statute of limitations applicable only to architects and contractors.<sup>78</sup> The *Skinner* court found determinative the lack of reasonable justification for granting architects and contractors a legal benefit not conferred on others whose negligence in the construction or improvement of a building could also lead to liability.<sup>79</sup> In *Wright v. DuPage Hosp. Ass'n*,<sup>80</sup> the same court struck down a statute attempting to limit to \$500,000 the maximum amount of damages which a malpractice plaintiff could recover against a physician or hospital.<sup>81</sup> Distinguishing the statute from the workers' compensation area, which also limits liability, the supreme court concluded that society derived no *quid pro quo* from the special favor given to physicians and hospitals.<sup>82</sup> Thus, it is not the classification itself which

79 Ill. 2d 295, 402 N.E.2d 560 (1979) (upholding absolute four-year statute of limitations period applicable only to medical malpractice actions); *Wright v. DuPage Hosp. Ass'n*, 63 Ill. 2d 313, 347 N.E.2d 736 (1976) (striking down maximum liability provision applicable solely to medical malpractice actions); *Skinner v. Anderson*, 38 Ill. 2d 455, 231 N.E.2d 588 (1967) (striking down absolute four-year statute of limitations period applicable only to architects and contractors).

77. 38 Ill. 2d 455, 231 N.E.2d 588 (1967).

78. *Id.* at 459-61, 231 N.E.2d at 590-91.

79. *Id.* at 460, 231 N.E.2d at 591. The *Skinner* court reasoned:

If, for example, four years after a building is completed a cornice should fall because the adhesive used was defective, the manufacturer of the adhesive is granted no immunity. And so it is with all others who furnish materials used in constructing the improvement. But if the cornice fell because of defective design or construction for which an architect or contractor was responsible, immunity is granted. It can not be said that the one event is more likely than the other to occur within four years after construction is completed.

*Id.*

80. 63 Ill. 2d 313, 347 N.E.2d 736 (1976).

81. *Id.* at 325-30, 347 N.E.2d at 741-43.

82. *Id.* at 327-28, 347 N.E.2d at 742. The court noted that under the Workers' Compensation Act, "the employer assumed a new liability without fault but was relieved of the prospect of large damage judgments, while the employee, whose monetary recovery was limited, was awarded compensation without regard to the employer's negligence." *Id.* at 327, 347 N.E.2d at 742. The *Wright* court further observed that workers' compensation law "provides for the payment of the employee's medical expenses and payment of compensation for the duration of his incapacity, which may exist throughout his life." *Id.*

The *Wright* court, however, found no such trade-off with the medical malpractice statute. The court pointed out that the malpractice statute, while granting a great privilege to the medical profession, "abolished no common law defenses, nor did it purport either to alter the essential elements of a cause of action for medical malpractice or lessen the plaintiff's burden of proof." *Id.* Further, in contrast to the guaranteed payments under workers' compensation, the malpractice statute lessened the plaintiff's recovery without any provision for the future of a "very seriously injured malpractice victim . . ." *Id.* at 327-28, 347 N.E.2d at 742.

Also relevant for purposes of analyzing the constitutionality of Public Act 84-1251, the *Wright* court drew a distinction between statutory limitations on purely statutory rights and statutory limitations on rights which existed at common law. While "the constitutional question is not formidable" in the former, it can be in the latter if there is no reasonable justification for the statute. *Id.* at 326, 347 N.E.2d at 742 (quoting *Hall v. Gillins*, 13 Ill. 2d 26, 29, 147 N.E.2d 352, 354 (1958)).



violates article IV, section 13, but the lack of a reasonable justification for singling out one particular group as deserving of a privilege that is denied to other, similar groups.

Applying these principles to Public Act 84-1251, it is evident that the lack of any reasonable justification for awarding accountants such a potent privity shield against tort liability provides potent ammunition for a constitutional attack under article IV, section 13. As demonstrated in the previous section of this Article, accountants have no more need for liability protection than do any other classes of Illinois professionals. To recall one specific example: any peculiar need that accountants had for special liability protection when they were members of a fledgling profession has long since vanished.<sup>83</sup> Further, as in *Skinner* and *Wright*, society scarcely benefits by allowing accountants to unilaterally control their negligence liability toward innocent third parties. Indeed, these innocent third parties often have no recourse against the fraudulent or mismanaged client who often is either insolvent or otherwise judgment-proof. This same lack of a *quid pro quo* proved fatal to the medical malpractice statute at issue in *Wright*.

It is of course true that, in *Anderson v. Wagner*,<sup>84</sup> the Illinois Supreme Court upheld legislation which had created a special statute of limitations for physicians and hospitals in malpractice actions.<sup>85</sup> *Anderson*, however, is simply an example of a special benefit conferred by legislation that was reasonably justified by the circumstances. The *Anderson* court found the legislature's articulated belief that a medical malpractice crisis existed was reasonable.<sup>86</sup> Going beyond the legislature's stated beliefs, the court noted that much empirical data had shown the existence of this medical malpractice crisis and the increasing difficulty medical providers had in trying to obtain medical malpractice insurance at reasonable rates.<sup>87</sup> This crisis, moreover, was limited to *medical* malpractice, thereby justifying the conferral of the special limitations period to medicine but not to other fields.<sup>88</sup>

This crisis justification, however, is absent with respect to Public Act 84-1251. To again draw on a previous section of this Article, the empirical evidence does not suggest any accountancy crisis due to the unavailability of accountant malpractice insurance.<sup>89</sup> Moreover, even if accountant malpractice insurance rates were unreasonably high, for example, there is nothing

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83. See *supra* note 65 and accompanying text for a discussion of the fledgling profession view as articulated in 1931.

84. 79 Ill. 2d 295, 402 N.E.2d 560 (1979).

85. *Id.* at 312-21, 402 N.E.2d at 568-72.

86. *Id.* at 316, 402 N.E.2d at 570. The *Anderson* court also relied heavily on the fact that many other states had limited medical malpractice liability in response to the crisis and all these statutes had been "uniformly upheld." *Id.* Public Act 84-1251, in contrast, is unique to American law.

87. *Id.* at 301-02, 402 N.E.2d at 562-63.

88. *Id.* at 316, 402 N.E.2d at 570.

89. See *supra* note 66.

to suggest that other professions do not share the problem in equal measure.<sup>90</sup>

In short, the General Assembly's failure to rationally differentiate accountants from other professionals who are equally concerned with malpractice liability raises the likelihood that Public Act 84-1251 will be struck down as a violation of article IV, section 13. But, regardless of whether Public Act 84-1251 is struck down by the Illinois courts as unconstitutional or is repealed by the General Assembly as a bad idea, the statute should not be part of the laws of Illinois. Allowing the statute to remain on the books increases the risk that more and more special interest legislation will develop for even more professions and occupations.

#### IV. CONCLUSION

In summary, Public Act 84-1251 is an aberration in the law of professional responsibility. It creates a special and unjustified status for Illinois public accountants by protecting them from a class of lawsuits with which every other profession must contend. It is likely that Public Act 84-1251 will someday be attacked as special legislation in violation of the Illinois Constitution and, given the lack of any reasonable justification for granting accountants the boon they obtain under the law, a strong case can be made for deeming this statute unconstitutional under Illinois law.

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90. The Illinois Supreme Court's decision in *People ex rel. Skinner v. Hellmuth, Obata & Kassabaum, Inc.*, 114 Ill. 2d 252, 500 N.E.2d 34 (1986) is also distinguishable. In *Hellmuth*, the supreme court was faced with the General Assembly's second attempt to draft a statute of limitations for architects and contractors; the first attempt had been struck down in *Skinner v. Anderson*, 39 Ill. 2d 455, 231 N.E.2d 588 (1967). See *supra* notes 77-79 and accompanying text for a discussion of *Skinner*. The second version, however, was different in several respects. First, instead of an absolute four-year limitations period as in *Skinner*, the new version provided that a plaintiff bring suit within two years of the time he or she knew or should have known of the act or omission. *Hellmuth*, 114 Ill. 2d at 260, 500 N.E.2d at 37. Although the statute provided an absolute limitations period of 12 years from the date of the act or omission, ILL. REV. STAT. ch. 110, para. 13-214(b) (1987), the constitutionality of this portion of the statute was not before the court. *Id. But cf. Blackwood v. Rusk*, 148 Ill. App. 3d 868, 500 N.E.2d 69 (3d Dist. 1986) (upholding 12-year statute-of-repose portion of the statute as reasonably related to the statute's stated purpose of circumscribing potentially unlimited tort liability of those who design and construct buildings). Second, the new version did not distinguish between architects and architect-owners as the previous statute had. *Id.*

The *Hellmuth* court upheld the statute as a reasonable classification by the General Assembly. The court first noted that the statute does not classify on the basis of status but rather on the activities performed, i.e., all who design or construct buildings derive its benefit. *Id.* at 261-62, 500 N.E.2d at 37-38. But the important factor for the *Hellmuth* court was the fact that the statute of limitations at bar—or at least as much of the statute as was before the court—was a traditional-type limitations period. The court reasoned: "The legislature has traditionally enacted statutes of limitations which vary as to the activity and the cause of action involved." *Id.* at 263, 500 N.E.2d at 38.

As noted above, however, Public Act 84-1251 is anything but a traditional limitation on liability. The rationale of *Hellmuth*, therefore, seems inapposite in assessing its constitutionality.

