THE FORESEEN, THE FORESEEABLE, AND BEYOND—ACCOUNTANTS' LIABILITY TO NONCLIENTS

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It is characteristic of our federal system that if a party were to litigate a controversy involving a single common-law issue in every one of the fifty-four common-law jurisdictions of the United States, he would neither win nor lose all of his cases, because of diverse findings of fact and interpretations of law among the courts. This certainly would be the case if the litigant were a professional accountant defending himself against liability for damages sustained by a nonclient resulting from alleged negligence in the accountant's professional work.[1] The accountant could, however, fare better in most courts than he would if he had to try his case in the law reviews,[2] given the great preponderance of sentiment favoring expansion of liability in this area.

This article explores the evolution of the law governing the liability of accountants to third parties and predicts how recent developments both in the literature and in some recent court decisions may affect the accounting profession. Specific attention will be given to the judicial interpretations and misinterpretations in United States opinions of the supposedly discrete terms—"primary benefit" ("end and aim"), "specifically (or 'actually') foreseen," and "reasonably foreseeable"—that are intended to subdivide an infinite range of varying factual situations. The article also considers the terms used and analyses made in cases with similar facts in the common-law jurisdictions of

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[1] A casual reader of this article might obtain the misimpression from the "adverse selection" of the relatively small number of accountants' controversies in proportion to the total engagements of the profession that accountants rarely do anything correctly; a similar misimpression would be received from similar papers concerning lawyers, doctors, and other professionals.

[2] *See, e.g.*, Besser, *Privity?—An Obsolete Approach to the Liability of Accountants to Third Parties*, 7 SETON HALL L. REV. 507 (1976); Wiener, *Common Law Liability of the Certified Public Accountant for Negligent Misrepresentation*, 20 SAN DIEGO L. REV. 233 (1983); Note, *Public Accountants and Attorneys: Negligence and the Third Party*, 47 NOTRE DAME LAW. 588 (1972).

the British Commonwealth. It confirms, by recognizing the inconsistencies of judicial interpretation and application, that the beauty of such terms of art, as in art generally, is in the eye of the beholder—each individual beholder. Finally, it suggests that the decisive influences in all of our seemingly objective deliberations on abstract issues of legal semantics may be our differing social, political, economic and ethical instincts and convictions.[3]

I. THE FORESEEN

A. *Restatement (Second) of Torts*

Out of the diversity of the United States common-law jurisdictions has emerged the *Restatements of the Law*, a product of legal practitioners working under the auspices of the prestigious American Law Institute, a nongovernmental institution. The objective of the *Restatements* is to identify and clarify the rules of common law that, based upon collective study and deliberation, are believed to reflect the views prevailing in judicial opinions of United States courts. The intent is to set forth the preponderant rules as they are, not as some of the deliberate participants think they should be. Ideally, a *Restatement* section is a synthesis of the majority judicial view on a common-law principle, cited to and often respected by courts, not as a binding precedent of a jurisdiction, but as the persuasive authority of other courts.

Section 552 of the *Restatement (Second) of Torts* (*Restatement* or section 552),[4] was published in 1977 following a study commenced in the early 1960's.[5] It limits the liability of a professional who has made a negligent misrepresentation (eg., in an audit opinion) 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.[6]

This formulation confines an accountant's liability to the persons or limited classes of persons whose reliance upon the negligent misrepre-

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[3] *See supra* note 2.

[4] RESTATEMENT (SECOND) OF TORTS § 552 (1977).

[5] *See id.* (Tent. Draft No. 10, 1964); *id.* (Tent. Draft No. 11, 1965); *id.* (Tent. Draft No. 12, 1966).

[6] *Id.* § 552(2)(a), (b).

sentation is (or, as in all cases, should be) *foreseen* or *specifically foreseen* by the accountant, and does not extend liability to those whose reliance is *foreseeable* or *reasonably foreseeable* to the accountant, but is not specifically foreseen by him.[7]

Regardless of the clarity of the *Restatement* formulation, interpretation of the section is sometimes obscured by misunderstandings of the difference between the terms foreseen and foreseeable. Some opinions, though accepting and applying the foreseen rule in accountants' liability cases, have misinterpreted it insofar as they employ the word foreseeable or some derivative of that term.[8] Conversely, one opinion refers to auditors' "further duty to those persons whom they can *reasonably foresee* will need to use and rely upon" the audited financial statements,[9] and to the formidable difficulties of attempting "to prove that an auditor *should have foreseen* the plaintiff's likely reliance upon some newspaper or a stock exchange reference to" the financial statements.[10] The potential for confusion is illustrated by the fact that, in the context of that opinion, the references actually relate to the justice's advocacy of "the comprehensible and straightforward test of *foreseeability*."[11]

On the other hand, a somewhat comparable reference to "an unlimited class of equity holders who could not be *reasonably foreseen* as a third party who would be expected to rely on a financial statement"[12] means *specifically foreseen* in the context of *that* opinion. A number of writers avoid this confusion by consistently adding descriptive adverbs that help in distinguishing the terms, as in *specifically* or *actually* foreseen and *reasonably* foreseeable.[13]

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[7] *See id.* comments h, i, j, illustrations 5-7, 10.

[8] *See* Aluma Kraft Mfg. Co. v. Elmer Fox & Co., 493 S.W.2d 378, 382-84 (Mo. Ct. App. 1973) (mentioning "foreseeability of harm," but applying "foreseen" concept of § 552); Haddon View Inv. Co. v. Coopers & Lybrand, 70 Ohio St. 2d 154, 157-58, 436 N.E.2d 212, 214-15 (1982) (discussing the "innocent third party who foreseeably relies," but applying "specifically foreseen" formulation of § 552); *see also* Bonhiver v. Graff, 311 Minn. 111, 129-30, 248 N.W.2d 291, 302 (1976); 999 v. Cox & Co., 574 F. Supp. 1026, 1032 (E.D. Mo. 1983) (Missouri law); Haig v. Bamford, 72 D.L.R.3d 68, 77 (Can. 1976). One writer, in comparing the merits of "the reasonably foreseeable test, and the actually foreseen test," endorsed "[t]he reasonably foreseeable test, which is best reflected in the Restatement[!]." Mess, *Accountants and the Common Law: Liability to Third Parties*, 52 NOTRE DAME LAW. 838, 857 (1977).

[9] Scott Group Ltd. v. McFarlane, [1978] 1 N.Z.L.R. 553, 575 (N.Z. Ct. App. 1977) (emphasis added) (defendant-auditor).

[10] *Id.* (emphasis added).

[11] *Id.* at 574 (emphasis added).

[12] Milliner v. Elmer Fox & Co., 529 P.2d 806, 808 (Utah 1974) (emphasis added) (defendant-accountant).

[13] *See* Rusch Factors, Inc. v. Levin, 284 F. Supp. 85, 93 (D.R.I. 1968) ("actually foreseen"; defendant-accountant).

B. *Significance of the* Restatement *to Accountants*

For a third of a century, from 1931 to the late 1960's, the law governing accountants' liability to nonclients was dominated by the towering opinion of Chief Judge Cardozo in the New York case of *Ultramares Corp. v. Touche.*[14] In declining to hold a negligent accountant liable to an unidentified nonclient, Judge Cardozo distinguished accountants from others because the extent of their potential liability would be excessive in comparison with the extent of their fault:

> If liability for negligence exists, a thoughtless slip or blunder, the failure to detect a theft or forgery beneath the cover of deceptive entries, may expose accountants to a *liability in an indeterminate amount for an indeterminate time to an indeterminate class.* The hazards of a business conducted on these terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of a duty that exposes to these consequences.[15]

Judge Cardozo also distinguished his earlier opinion in the "bean weighers' " case of *Glanzer v. Shepard*[16] in which defendant-public weighers, who were engaged by a seller of beans to certify the weight to the buyer, were held liable for negligently producing an overweight certificate on which the buyer relied in paying the seller. In that case Judge Cardozo had reasoned: "The plaintiffs' use of the certificates was not an indirect or collateral consequence of the action of the weighers. It was a consequence which, to the weighers' knowledge, was the *end and aim* of the transaction."[17] The service provided by the accountant in *Ultramares,* however, "was *primarily for the benefit of the* [*client*] . . . and only incidentally or collaterally for the use of those to whom [the client] and his associates might exhibit it thereafter."[18]

The criticism of *Ultramares* had its genesis in subsequent overly-rigorous interpretations of the "primarily for the benefit" language. One might have expected the New York courts to apply the "end and

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[14] 255 N.Y. 170, 184, 187, 174 N.E. 441, 446, 447 (1931) (citing Derry v. Peek, 14 App. Cas. 337 (1889) (no third-person liability for negligent misstatement in prospectus); Landell v. Lybrand, 264 Pa. 406, 107 A. 783 (1919) (accountant-defendant had no duty of care to "stranger")).

[15] *Id.* at 179-80, 174 N.E. at 444 (emphasis added).

[16] 233 N.Y. 236, 135 N.E. 275 (1922).

[17] *Id.* at 238-39, 135 N.E. at 275 (emphasis added).

[18] *Ultramares,* 255 N.Y. at 183, 174 N.E. at 446 ("In a word, the service rendered by the defendant in *Glanzer v. Shepard* was primarily for the information of a third person, in effect, if not in name, a party to the contract, and only incidentally for that of the formal promisee.").

aim" test of the bean weighers' case to impose liability on a negligent accountant who knew that the product of his services would be relied on by a nonclient known to him.[19] In *State Street Trust Co. v. Ernst*,[20] however, the New York Court of Appeals arrived at a different result. In that case, the accountant knew that the plaintiff intended to rely on the client's audited financial statements in deciding whether to make a loan to the client. The court, with no mention of the bean weighers' case, interpreted the primary benefit language of *Ultramares* as absolving the accountant of negligence "in the absence of a contractual relationship or its equivalent."[21] As a consequence, *Ultramares* came to symbolize a requirement of privity of contract which in hindsight appears to be a more rigorous requirement than Judge Cardozo may have intended in either *Ultramares* or *Glanzer*.

The privity of contract limitation ascribed to *Ultramares* pervaded accountants' liability decisions for decades, both in the United States and in the British Commonwealth.[22] In the 1951 United Kingdom case of *Candler v. Crane Christmas & Co.*,[23] the defendant-auditor's employees negligently "prepared" a client's "accounts" (financial statements). The defendant knew that the financial statements were to be used to induce the plaintiff to make an investment in the client and, at the client's request, the defendant actually presented them to the plaintiff and discussed them with the plaintiff and his client.[24] Nevertheless, a majority of the justices held that the defendant had no duty of care to the plaintiff for the resulting loss of his investment. Although the majority primarily considered the court to be bound (under a rule of the court) by controlling English precedent,[25] one of the two justices devoted considerable attention in his opinion to quotations from *Ultramares*,[26] and expressed satisfaction

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[19] See Seedkem, Inc. v. Safranek, 466 F. Supp. 340, 342 n.1 (D. Neb. 1979) (construing Nebraska and Indiana law), and Investment Corp. of Fla. v. Buchman, 208 So. 2d 291, 295 n.3 (Fla. Dist. Ct. App. 1968), in both of which the defendants were accountants.

[20] 278 N.Y. 104, 15 N.E.2d 416 (1938) (defendant-auditor). For additional defendant-auditor cases under New York law, see C.I.T. Fin. Corp. v. Glover, 224 F.2d 44 (2d Cir. 1955); O'Connor v. Ludlam, 92 F.2d 50 (2d Cir.), *cert. denied*, 302 U.S. 758 (1937); Duro Sportswear, Inc. v. Cogen, 131 N.Y.S.2d 20 (Sup. Ct. 1954), *aff'd mem.*, 285 A.D. 867, 137 N.Y.S.2d 829 (App. Div. 1955).

[21] *State St. Trust*, 278 N.Y. at 111, 15 N.E.2d at 418.

[22] *See, e.g.*, O'Connor v. Ludlam, 92 F.2d 50 (2d Cir.), *cert. denied*, 302 U.S. 758 (1937); Duro Sportswear, Inc. v. Cogen, 131 N.Y.S.2d 20 (Sup. Ct. 1954), *aff'd mem.*, 285 A.D. 867, 137 N.Y.S.2d 829 (App. Div. 1955); Candler v. Crane Christmas & Co., [1951] 1 All E.R. 426 (C.A.).

[23] [1951] 1 All E.R. 426 (C.A.).

[24] *Id.* at 428-29.

[25] *Id.* at 437 (citing Le Lievre v. Gould, [1893] 1 Q.B. 491).

[26] *Id.* at 447-49.

that his conclusion "on the basis of the English authorities seems to accord with the opinion of so eminent a student of the common law as CARDOZO, C.J."[27]

In a strong dissent, the distinguished and influential Lord Denning argued with prescience that an accountant's duty to avoid negligence should extend not only to his employer and client but also:

> to any third person to whom [the accountants] themselves show the accounts, or to whom they know their employer is going to show the accounts so as to induce him to invest money or take some other action of them. . . . [H]owever, the duty [should not] be extended still further so as to include strangers of whom they have heard nothing and to whom their employer without their knowledge may choose to show their accounts.[28]

Such a duty to nonclients, the dissent reasoned, should be confined:

> to cases where the accountant prepares his accounts and makes his report for the guidance of the very person in the very transaction in question. . . .[29] Whether he would be liable if he prepared his accounts for the guidance of a specific class of persons in a specific class of transactions, I do not say. I should have thought he might be. . . .[30]

In 1963, Lord Denning's dissent was cited approvingly, and the majority opinions were *expressly* disapproved, by the House of Lords in *Hedley Byrne & Co. v. Heller & Partners, Ltd.*[31] In *Hedley Byrne,* defendant-bank had negligently worded an accommodation credit report concerning one of its customers to a second bank. Plaintiff, a customer of the second bank, relied on the report to its detriment in advancing credit to the defendant's customer.[32] The justices appeared to agree in theory that the defendant could be held liable[33] upon a finding of a "special duty" owed by the defendant to the plaintiff-lender arising from the existence of a "special relationship" between

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[27] *Id.* at 450.

[28] *Id.* at 434.

[29] *Id.* at 435 (quoting Cardozo's "indeterminate" language in *Ultramares,* 255 N.Y. at 179-80, 174 N.E. at 444).

[30] *Id.*

[31] [1964] A.C. 465 (H.L. 1963).

[32] *Id.* at 467-69.

[33] Nevertheless, because the defendants had specifically disclaimed responsibility for the reliability of their report, the court found no duty of care arose, thus exculpating the defendants. *E.g., id.* at 492-93, 540.

the parties.[34] The justices' use of the terms "special relationship" and "special duty" has led some United States lawyers to conclude that the *Hedley Byrne* decision was somewhat less than clear in providing a legal standard for courts to follow. The *Restatement* reporter described the opinion as "quite vague, and not in agreement," and stated that "[t]he case obviously throws little light" on the issue.[35]

As will be discussed later in this article,[36] it has become clear that, in the context of both earlier and later opinions, "special relationship" and "special duty" are terms of art in United Kingdom-Commonwealth law, with associations of meaning that are not readily apparent to nonreaders of those opinions. The *Restatement* reporter, however, did summarize *Hedley Byrne* in the discussion of the 1965 Tentative Draft of section 552, because, in the absence of a controlling precedent of the jurisdiction, state supreme courts may "look to the entire body of Anglo-American law" in determining an issue.[37] Indeed, the *Hedley Byrne* decision and other United Kingdom-Commonwealth decisions have been relied on by the United States courts in cases of first impression.[38]

The concept of a specifically foreseen person and limited class of persons in the present section 552 dilutes the *Ultramares* rationale and appears (superficially, it turns out) to be in harmony with the opinions in the English case of *Hedley Byrne* and especially with the prophetic dissent in *Candler,* as well as with other judicial opinions in cases against accountants.[39] Section 552, consistent with the general purpose of the *Restatement,* attempts to synthesize these prevailing opinions into one coherent standard. Regardless of the potential for some courts to confuse its terms,[40] at this time the section represents the best effort to provide guidelines[41] for determining the liability of accountants and putting them on notice as to whom they will be liable for their negligent conduct.

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[34] See *infra* notes 172-84 and accompanying text for discussion of the court's use of these terms.

[35] RESTATEMENT (SECOND) OF TORTS § 552, at 56 (Tent. Draft No. 11, 1965).

[36] *See infra* notes 172-84 and accompanying text.

[37] See Seedkem, Inc. v. Safranek, 466 F. Supp. 340, 341 (D. Neb. 1979) (construing Nebraska and Indiana law), and Rusch Factors, Inc. v. Levin, 284 F. Supp. 85, 89 (D.R.I. 1968) (construing Rhode Island and New York law), in both of which the defendants were accountants.

[38] *See, e.g.,* Rusch Factors, Inc. v. Levin, 284 F. Supp. 85, 92 (D.R.I. 1968).

[39] *See, e.g., id.;* Ryan v. Kanne, 170 N.W.2d 395, 401-02 (Iowa 1969).

[40] *See supra* notes 8-13 and accompanying text.

[41] The comments to § 552 provide specific illustrations of the potential liability of an auditor possessing various degrees of knowledge of the client's stated purpose of the audit. RESTATEMENT

C. *Some Continuing Adherence to Privity of Contract*

During the two decades since the tentative revision of section 552 was first circulated, some courts have refused to find accountants liable to nonclients for negligence in the absence of privity of contract.[42] In all of these cases, *Ultramares* has been relied on as a primary authority, even though in most of those cases, the defendant-accountants would, or at least might, have been liable under a specifically foreseen person or limited class theory. Some of the plaintiffs in

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(SECOND) OF TORTS § 552, comment h, illustrations 5, 6, 7 & 10, at 134-35 (1977): (5) for submission to X bank (only) in obtaining a loan, upon failure of X bank, submitted to Y bank for a loan, without notice to the auditor; auditor not liable to Y bank; (6) for submission in obtaining a loan from some bank, naming X bank as a possibility; auditor liable to Y bank; (7) for submission in obtaining a loan from some bank; auditor liable to Y bank; . . . (10) annual audit, with no stated intention concerning use, though auditor knows of customary use of past financial statements and audit opinions in numerous business, financial, and investment transactions [as in *Ultramares*]; submitted in obtaining a loan from X bank; auditor not liable to X bank. *See id.*

In addition, the reliance requirement of § 552 is interpreted in the comments to the section as follows:

> Thus independent public accountants who negligently make an audit of books of a corporation, which they are told is to be used only for the purpose of obtaining a particular line of banking credit, are not subject to liability to a wholesale merchant whom the corporation induces to supply it with goods on credit by showing him the financial statements and the accountant's opinion. On the other hand, it is not necessary that the transaction in which the opinion is relied on shall be identical in all of its minute details with the one intended. It is enough that it is substantially the same transaction or one substantially similar.

Id., comment j, at 137.

[42] In chronological sequence: Investment Corp. of Fla. v. Buchman, 208 So. 2d 291 (Fla. Dist. Ct. App. 1968) (plaintiff-investor is client known to auditor; court discussed § 552 and *Glanzer*, 233 N.Y. at 236, 135 N.E. at 275 (miscategorized as third-party beneficiary case), but considered itself bound by *State St. Trust*, 278 N.Y. at 104, 15 N.E.2d at 416, and Florida precedent); Canaveral Capital Corp. v. Bruce, 214 So. 2d 505 (Fla. Dist. Ct. App. 1968) (plaintiff-lender to client appealed jury verdict for accountant submitted on negligence theory; court followed *Investment Corp. of Fla.*, 208 So. 2d at 291); Stephens Indus., Inc. v. Haskins & Sells, 438 F.2d 357, 359-60 (10th Cir. 1971) (plaintiff-purchasers of majority stock of client, known to auditor; in construing Colorado law in diversity case, "the rule and reasoning of Ultramares has predominated," and, citing recent foreseen person and class cases, requiring "substantial evidence showing that Colorado would align itself with the developing trend"; additionally, auditors exercised due care); MacNerland v. Barnes, 129 Ga. App. 367, 370-71, 199 S.E.2d 564, 566 (Ct. App. 1973) (plaintiff-investors in client known to accountant; unaudited financial statements; "Ultramares stands as the majority rule and we see no reason to depart from its rationale"); Koch Indus., Inc. v. Vosko, 494 F.2d 713, 725 (10th Cir. 1974) (plaintiff-purchaser of client not foreseen person because audit had been performed for earlier proposed purchaser; Kansas law was determined to follow *Ultramares*, 255 N.Y. at 170, 174 N.E. at 441; "It also appears from the record that the law in the Bahamas is basically the same," citing *Hedley Byrne*, [1964] A.C. at 465), *aff'g*, [1972-1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,705, at 93,133 (D. Kan. 1972) (Kansas law determined to require privity of contract; "the law of England would follow that in *Ultramarac* [sic]," with no citation of United Kingdom

those cases might also have prevailed under a liberal interpretation of the *Glanzer* "end and aim" test. Indeed, in cases of allegedly negligent practices of persons in other professions and callings whose services ordinarily affect only one or very few nonclients or noncustomers, courts have tended to be more receptive to the economic grievances of the latter. Some examples include a lawyer vis-à-vis intended but disqualified beneficiaries of a will,[43] a land surveyor,[44] title abstractor,[45] or building inspector vis-à-vis a successor owner of property,[46] an architect vis-à-vis a building contractor,[47] and an insurance agent confirming coverage vis-à-vis his insurance client.[48] Those opinions suggest an analogy, though strained in varying degrees, to the end and aim rule of *Glanzer.*

The opinions of the courts in New York, the state of origin of *Ultramares* and *Glanzer,* require closer attention because they frequently are cited in opinions of other jurisdictions, particularly in cases of first impression. In *White v. Guarente,*[49] the defendant-accountant had been engaged by a limited partnership with approximately forty limited partners to perform auditing and tax return services pursuant to the partnership agreement. Plaintiff, one of the limited partners, alleged negligence by the accountant in knowing of and failing to disclose large withdrawals of funds by the general partners in violation of the partnership agreement. The court purported to distinguish *Ultramares:*

Authority); Nortek, Inc. v. Alexander Grant & Co., 532 F.2d 1013, 1015 (5th Cir. 1976) (plaintiff-purchaser of client known to auditor; federal court bound by Florida decisions, citing *Investment Corp. of Fla.*, 208 So. 2d at 291); William Iselin & Co. v. Muhlstock, Elowitz & Co., 52 A.D.2d 540, 382 N.Y.S.2d 83 (App. Div. 1976); Investors Tax Sheltered Real Estate, Ltd. v. Laventhol, Krekstein, Horwath & Horwath, 370 So. 2d 815 (Fla. Dist. Ct. App. 1979) (annual audit; plaintiff not a foreseen person; *Investment Corp. of Fla.*, 208 So. 2d at 291 and *Canaveral,* 214 So. 2d at 505, followed; additionally, defendant-auditor found not negligent); McLean v. Alexander, 599 F.2d 1190, 1202 (3d Cir. 1979) (plaintiff known purchaser of client; Delaware law); *see also* Donovan Constr. Co. v. Woosley, 358 F. Supp. 375, 382-83 (W.D. Ark. 1973) (judgment for defendant-accountant; no negligence; no reliance by plaintiff; Arkansas law).

[43] Auric v. Continental Casualty Co., 111 Wis. 2d 507, 331 N.W.2d 325 (1983); Ross v. Caunters, [1979] 3 All E.R. 580 (Ch.); *see* Annot., 45 A.L.R. 3d 1181 (1972).

[44] Rozny v. Marnul, 43 Ill. 2d 54, 250 N.E.2d 656 (1969).

[45] See cases cited in Annot., 34 A.L.R. 3d 1122 (1970).

[46] Dutton v. Bognor Regis United Bldg. Co., [1972] 1 All E.R. 462 (Q.B.).

[47] A.R. Moyer, Inc. v. Graham, 285 So. 2d 397 (Fla. 1973).

[48] Lesser v. William Holliday Cord Assocs., Inc., 349 F.2d 490 (8th Cir. 1965) (Missouri law).

[49] 43 N.Y.2d 356, 359, 372 N.E.2d 315, 317, 401 N.Y.S.2d 474, 476 (1977). For a case involving similar facts, see Haddon View Inv. Co. v. Coopers & Lybrand, 70 Ohio St. 2d 154, 436 N.E.2d 212 (1982) (foreseen class of four limited partners against accountant).

> Here, the services of the accountant were not extended to a faceless or unresolved class of persons, but rather to a known group . . . [of] actual limited partners, fixed and determined. . . . [T]he accountant must have been aware that a limited partner would necessarily rely on or make use of the audit and tax returns of the partnership, or at least constituents of them, in order to properly prepare his or her own tax returns.[50]

The court then invoked the bean weighers' case: "Here, too, the furnishing of the audit and tax return information, necessarily by virtue of the relation, was *one of the* ends and aims of the transaction."[51] But, with apparent significance, it concluded its reasoning in the classic rubric of the foreseen limited class rule of section 552, though not citing it expressly, by referring to a discussion in the opinion of another court concerning inroads on *Ultramares*:

> "The courts in diminishing the impact of *Ultramares* have not only embraced the rule of *Glanzer*—liability to a foreseen plaintiff—but have extended an accountant's liability for negligence to those who, although not themselves foreseen, are members of a limited class whose reliance on the financial statements is specifically foreseen." *Here, plaintiff was a member of a limited class whose reliance on the audit and returns was, or at least should have been, specifically foreseen.*[52]

It is understandable that the Ohio Supreme Court, in ruling for plaintiffs in a similar suit against accountants, should observe that: "Significantly, the strict interpretation of *Ultramares* has now been rejected by the court which formulated the rule. . . . We find the interpretation of *Ultramares* set forth in *White v. Guarente* to accord with reason and justice. Moreover, the Restatement of Torts 2d and various commentators have come to the same conclusion."[53] Also, in a

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[50] *White*, 43 N.Y.2d at 361, 372 N.E.2d at 318-19, 401 N.Y.S.2d at 477-78 (citations omitted).

[51] *Id.* at 362, 372 N.E.2d at 319, 401 N.Y.S.2d at 478 (emphasis added).

[52] *Id.* (quoting Hochfelder v. Ernst & Ernst, 503 F.2d 1100, 1107 (7th Cir. 1975), *rev'd on other grounds*, 425 U.S. 185 (1976) (emphasis added)).

[53] Haddon View Inv. Co. v. Coopers & Lybrand, 70 Ohio St. 2d 154, 156, 436 N.E.2d 212, 214 (1982) (citations & footnote omitted) (defendant-auditor); *see* Spherex, Inc. v. Alexander Grant & Co., 122 N.H. 898, 903-04, 451 A.2d 1308, 1311 (1982) (defendant-auditor); H. Rosenblum, Inc. v. Adler, 183 N.J. Super. 417, 421-22, 444 A.2d 66, 68 (App. Div. 1982), *aff'd in part, rev'd in part*, 92 N.J. 324, 461 A.2d 138 (1983) (defendant-auditor); *infra* notes 117-50 for a discussion of the *Rosenblum* decision.

nonaccountant case, the Court of Appeals for the Second Circuit, after analyzing *White*, *Ultramares*, and *Glanzer*, applied section 552, predicting that the New York courts would so apply it in a noncontract case, and finding that "the critical factor in the relationship between the parties is their reasonable expectations, not their formal legal relationship."[54] Some courts, however, have read *White* differently, regardless of the interpretation of the opinion by the Ohio Supreme Court and the Second Circuit. In *Dworman v. Lee*,[55] a 1981 New York intermediate appeals court decision, the court concluded that "there can be no doubt that the rule in *Ultramares* remains authoritative, as it was in fact reaffirmed in *White v. Guarente*." Subsequent New York opinions have come to the same conclusion.[56]

The decisions reviewed or footnoted above adhered to the traditional rule of denying damages to nonclients because of lack of privity of contract with the accountants. Of all these cases only in *White*, which at least arguably applied this rule, did the ruling go against the accountants.[57] Nevertheless, even these early cases hinted at the limitation *Ultramares* would undergo in the specifically foreseen person and class cases. As a result of changing times, conditions, and sentiments, *Ultramares* has been diminished,[58] "weakened"[59] and "eroded"[60] by reinterpretation to such an extent that contemporary *Ultramares* would scarcely be recognizable to Judge Cardozo or the judges of *State Street Trust*.

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[54] Mallis v. Bankers Trust Co., 615 F.2d 68, 82-83 (2d Cir. 1980) (New York common-law negligence claim pendent to federal securities law action), *cert. denied*, 449 U.S. 1123 (1981).

[55] 83 A.D.2d 507, 507, 441 N.Y.S.2d 90, 91 (App. Div. 1981), *aff'd mem.*, 56 N.Y.2d 816, 438 N.E.2d 103, 452 N.Y.S.2d 570 (1982).

[56] *See* Aeronca, Inc. v. Gorin, 561 F. Supp. 370, 376 (S.D.N.Y. 1983) (defendant-auditor not liable for negligence to client's creditor/subcontractor); International Paper Co. v. Fox & Co. (N.Y. Sup. Ct. 1984), N.Y.L.J., Jan. 20, 1984, at 6, col. 4; Herman v. Bruns, Nordeman, Rea & Co., No. 91278/82 (N.Y. Sup. Ct. Mar. 17, 1983); European Am. Bank & Trust Co. v. Strauhs & Kaye, No. 19904/83 (N.Y. Sup. Ct. Aug. 12, 1983).

[57] In any case, the court did regard the plaintiffs, who were limited investment partners of the tax shelter, as nonclients of the defendant-accountant. The opinion did not refer to the traditional partnership law concept that a partnership is not a separate entity, but is personified by each partner; plaintiffs could have been brought into privity by a strained application of that entity concept. In a suit by general (noninvestment) "working" partners of a partnership against the partnership's accountants, a court might find privity of contract between the accountant and the partners.

[58] Hochfelder v. Ernst & Ernst, 503 F.2d 1100, 1107 (7th Cir. 1974), *rev'd on other grounds*, 425 U.S. 185 (1976); Seedkem, Inc. v. Safranek, 466 F. Supp. 340, 342 (D. Neb. 1979) (defendant-auditors).

[59] Seedkem, Inc. v. Safranek, 466 F. Supp. 340, 342 (D. Neb. 1979); Bonhiver v. Graff, 311 Minn. 110, 127, 248 N.W.2d 291, 301 (1976) (defendant-auditors).

[60] Seedkem, Inc. v. Safranek, 466 F. Supp. 340, 343 (D. Neb. 1979).

One wonders about the extent and full implications of the revitalization of *Glanzer* evidenced in a number of opinions, particularly in *White,* which referred to the case in finding the reliance of forty or so limited partners to be *one* of the ends and aims of the accountant's engagement—no longer *the* end and aim, and no longer the lone buyer of beans. Forty is not a small number, and the reliance of limited partners on financial information is comparable to reliance by shareholders on corporate financial information, except in one regard: The use of a partnership rather than a corporate vehicle in *White* and in the similar Ohio case[61] was oriented to income tax strategy. A corporate shareholder's investment income, which is reportable for federal income tax purposes, is usually the dividends actually received. A partner, on the other hand, computes his federal income taxes on the basis of his contractual share of the income or the loss, and certain specially treated tax deductions and tax credits, as reported in the partnership income tax return. This is the case irrespective of whether the partner receives any distributions from the partnership. Consequently, erroneous partnership data are much more directly sensitive to an aggrieved partner than are erroneous corporate data to an aggrieved shareholder.

White would appear to admit any number of limited partners into the charmed circle of the end and aim—be they four as in the Ohio case, forty as in *White,* 400 or 4,000. Shareholders—be they four, forty, 400 or 4,000—in corporations that are comparable in nature and different only in tax strategy would be excluded, not only from the end and aim category in privity of contract jurisdictions, but also from the specifically foreseen class of the *Restatement.* Shareholders thus would be banished into the outer darkness of the merely foreseeable and left to their remedies, if any, in fraud. For the 400 or 4,000 limited partners, the end and aim would have been transformed from an illusory goal into a weapon of aggression—a serendipitous bonus to the tax shelter investor—and for accountants, from a shield into a scourge.

White is not easily reconcilable with the orthodox *Ultramares* opinions, as is attested to by the divergent interpretations of the opinions by other courts discussed above.[62] Despite *Dworman, Ultramares* has been interpreted by a New York trial court as "modified"

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[61] Haddon View Inv. Co. v. Coopers & Lybrand, 70 Ohio St. 2d 154, 436 N.E.2d 212 (1982); *see* discussion *supra* text accompanying note 53.

[62] *See* Aeronca, Inc. v. Gorin, 561 F. Supp. 370, 376 (S.D.N.Y. 1983) (citing *Ultramares,* 255 N.Y. at 170, 174 N.E. at 441, as law of New York and referring to *White,* 43 N.Y.2d at 356,

(as opposed to being followed) by *White* as to limited partners.[63] This is essentially an arbitrary distinction. The *White* opinion cannot quite withstand analysis, and thus will continue to cause difficulty.

D. *Specifically Foreseen Person and Limited Class*

Some of the specifically foreseen person and limited class opinions attempt, albeit unpersuasively, to equate or at least to reconcile the concept of section 552 with the rationale of the *Ultramares* and bean weighers' cases, and, although appearing to succeed, have further distorted those cases. Moreover, the opinions reveal that courts tend to be more comfortable with identifying one or a few specific *persons* than with identifying a specific limited *class*. Opinions involving contention between the foreseen and privity of contract rules are discussed here, and those between the foreseen and the reasonably foreseeable rules are discussed below under "The Foreseeable."

Opinions are cited in the specifically foreseen category if they endorse any of several types of authority—section 552 or opinions that embrace the specifically foreseen person or class—either United States opinions or *Hedley Byrne* or other United Kingdom-Commonwealth opinions. The United Kingdom-Commonwealth opinions, although discussed briefly here, are left primarily for separate attention, because of differences in tradition, idiom, process of thought, and—as will be seen—trend. Although cases dealing with nonaudit services raise contentious questions of professional standards and performance, they are not classified separately here because essentially they are similar to audit cases as to the issue of whether a plaintiff's reliance was "foreseen" or "foreseeable."

1. Specifically Foreseen Person

The first reported United States accountant case opinion subsequent to *Hedley Byrne*, and one that drew support from that case and the *Candler* dissent, was the 1968 case of *Rusch Factors, Inc. v. Levin*.[64] In *Rusch*, a New York plaintiff brought suit in the Federal District Court for the District of Rhode Island seeking damages alleg-

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372 N.E.2d at 315, 401 N.Y.S.2d at 474, as "an apparent exception to the rule"); *see also* cases cited *supra* notes 53-54.

[63] Herman v. Bruns, Nordeman, Rea & Co., No. 91278/82, slip op. at 2 (N.Y. Sup. Ct. Mar. 17, 1983).

[64] 284 F. Supp. 85, 90-92 (D.R.I. 1968) (citing *Hedley Byrne*, [1964] A.C. at 465, and *Candler*, [1951] 1 All E.R. at 426).

edly resulting from the Rhode Island defendant-auditor's negligent misrepresentation of the financial condition of the corporation to which the plaintiff, in reliance on the defendant's representations, extended credit.[65] By a curious conflict of laws analysis, the court found it unnecessary to decide whether the alleged tort had occurred in Rhode Island, the location of the defendant-auditor and his borrower-client and, in the perception of the court (though without any close precedent), a section 552 state, or in New York, the location of the single specifically foreseen lender, with its *Ultramares* and bean weighers' tradition. Rather, the court resorted to the generality that the laws of both states are "grounded on the same theory of risk distribution"[66] and, without considering how each state might have evaluated this theory with respect to the specific facts of the case, reasoned that no conflict of laws existed. The court concluded that under the circumstances it would "look to the entire Anglo-American body of law."[67]

After a conventional citation of law review articles expressing doubt as to the wisdom of *Ultramares*, the court found the case at hand "qualitatively distinguishable from *Ultramares*"[68] and its "undefined, unlimited class of remote lenders . . . not actually foreseen but only foreseeable,"[69] and "far more akin to the case of *Glanzer v. Shepard*."[70] The court did stop short of asserting that the single actually foreseen plaintiff-lender was equivalent to the buyer of beans, although later it stated (in separate passages) that the financial statements in both *Candler* and in *Rusch* had the "very aim and purpose [sic]" of reliance by a known plaintiff.[71] Then, despite the New York precedent of *State Street Trust*, which had applied *Ultramares* against a known reliant third-person plaintiff, the court made the amazing statement that "[i]n fact, the *Glanzer* principle has been applied to accountants."[72] In the related discussion the court cited section 552, the *Candler* dissent, and the *Hedley Byrne* decision, none of which offer direct support for this proposition. The court concluded that an accountant could be liable for the negligent misrepresentations he

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[65] *Id.* at 86-87.
[66] *Id.* at 89; *see also id.* at 89-90 n.5 (employing phrase "basically the same").
[67] *Id.* at 89.
[68] *Id.*
[69] *Id.*
[70] *Id.* (citation omitted).
[71] *Id.* at 92, 93.
[72] *Id.* at 91.

makes to "actually foreseen and limited classes of persons."[73] Consequently, it ruled against the accountant on his motion for dismissal.

Thus, the Federal District Court of Rhode Island, obviously determined to apply the specifically foreseen person concept of section 552, and without citing any supporting substantive Rhode Island precedent, established a vogue followed by other courts. The opinion avoided the influence of the New York opinions, despite the admission that according to more modern conflict of laws analysis, the law of New York appeared to be more appropriate than that of Rhode Island.[74] In sum, the opinion has contributed to an interpretation of *Ultramares* and *Glanzer* that is quite different from the way in which those rulings were conceived by Judge Cardozo.

The *Rusch* opinion soon was followed in favor of a similar type of plaintiff in the Iowa case of *Ryan v. Kanne*,[75] in which the court relied primarily upon *Rusch*, the bean weighers' case, and cases against abstractors and against lawyers sued by will-beneficiaries.[76] Because the plaintiff was the acquirer of these defendant-accountant's client, the court had no occasion to reflect on the fact that, unlike professional accountants in general, the potential liability exposure of the defendants in all of the cited opinions was limited to one or a very few persons other than their respective clients or customers. Additionally, the court cited section 552 as "also" supporting the conclusions of those opinions.[77] The court cited no controlling Iowa precedent.

The above cases were followed by a series of opinions in similar United States cases against accountants, with all but one ruling in favor of the single specifically foreseen person lending to or acquiring the accountant's client. In all of these cases the court distinguished or refused to follow *Ultramares*, and relied primarily on *Glanzer* as refashioned by *Rusch*, section 552, or both.[78]

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[73] *Id.* at 93.

[74] *Id.* at 89 n.5. Moreover, the court acknowledged the absence of any Rhode Island statute or judicial precedent on the choice of law problem. *Id.* at n.4.

[75] 170 N.W.2d 395, 401-02 (Iowa 1969) (actually a cross-claim plaintiff, acquirer of client's business, in plaintiff-accountant's ill-fated suit for professional fee for nonaudit accounting services; negligence in investigation of accounts payable).

[76] *Id.* at 401-02.

[77] *Id.*

[78] In chronological sequence: Shatterproof Glass Corp. v. James, 466 S.W.2d 873 (Tex. Civ. App. 1971) (acquirer of client; advocating § 552 as law of Texas; also following *Glanzer*, 233 N.Y. at 236, 135 N.E. at 275, *Rusch*, 284 F. Supp. at 85, and architect, will beneficiary-lawyer, and property damage cases); Rhode Island Hosp. Trust Nat'l Bank v. Swartz, Bresenoff, Yavner & Jacobs, 455 F.2d 847, 851 (4th Cir. 1972) (lender; failure to detect nonexistence of capitalized improvements; following *Rusch*, 284 F. Supp. at 85, interpretation of Rhode Island law and

Seedkem, Inc. v. *Safranek*[79] resists neat classification, either among the foreseen, the foreseeable, and the general public, or between a person and a class. The case is interesting as an illustration of bewilderment, and as a reproach to the efforts of legal writers to classify everything. In *Seedkem*, which involved a suit by a trade creditor against the allegedly negligent accountant of the debtor, the plaintiff put its worst foot forward by contending "that defendant was aware that the [unaudited] financial statements prepared by him were for distribution to the *general public*, particularly the plaintiff . . . , and that the financial statements would be relied upon by *businesses such as* plaintiff."[80] According to such a contention, plaintiff may have been no more than a member of the unlimited class of the public, or at best a member of an allegedly protected class of "businesses" not otherwise specified, perhaps foreseeable though not actually foreseen. On the other hand, the opinion alluded to the

§ 552, and citing *Hedley Byrne*, [1964] A.C. at 465, and dissent in *Candler*, [1951] 1 All E.R. at 428); Aluma Kraft Mfg. Co. v. Elmer Fox & Co., 493 S.W.2d 378, 384 n.7 (Mo. Ct. App. 1973) (acquirer of client; cumulatively material effect of alleged negligence regarding 13 items; following *Glanzer*, 233 N.Y. at 236, 135 N.E. at 275, *Rusch*, 284 F. Supp. at 85, and § 552, and citing *Hedley Byrne*, [1964] A.C. at 465, and dissent in *Candler*, [1951] 1 All E.R. at 428); Bunge Corp. v. Eide, 372 F. Supp. 1058, 1063 (D.N.D. 1974) (lender; inventory valuation; diversity case construing North Dakota law; following § 552 as a "better rule" than *Ultramares*, 255 N.Y. at 170, 174 N.E. at 441, but ruling for defendant under either theory because of (1) no reliance by plaintiff, and (2) no negligence by auditor—the latter at least disputable on facts stated in opinion); Coleco Indus., Inc. v. Berman, 423 F. Supp. 275, 308-10 & 310 n.59 (E.D. Pa. 1976) ("obvious and mechanical" errors; reliance on unaudited financial statements by client's five shareholders in negotiating with acquirer of client; pendent common-law claim in securities law action, construing Pennsylvania and New Jersey law; following *Glanzer*, 233 N.Y. at 236, 135 N.E. at 275, *Rusch*, 284 F. Supp. at 85, and distinguishing *Ultramares*, 255 N.Y. at 170, 174 N.E. at 441, and Pennsylvania precursor, Landell v. Lybrand, 264 Pa. 406, 107 A. 783 (1919); § 552 not mentioned), *aff'd in part, remanded in part on other grounds*, 567 F.2d 569 (3d Cir. 1977), *cert. denied*, 439 U.S. 830 (1978); Spherex, Inc. v. Alexander Grant & Co., 122 N.H. 898, 451 A.2d 1308 (1982) (trade creditor, unaudited financial statements; on certification of questions from federal district court in diversity case of first impression under New Hampshire law; following other specifically foreseen person opinions and § 552); Tiffany Indus., Inc. v. Harbor Ins. Co., 536 F. Supp. 432, 434 (W.D. Mo. 1982); 999 v. Cox & Co., 574 F. Supp. 1026, 1031 (E.D. Mo. 1983) (following *Aluma Kraft*, 493 S.W.2d at 378, under Missouri law); see Commonwealth opinions involving acquisition of client: Dimond Mfg. Co. v. Hamilton, [1969] N.Z.L.R. 1609 (N.Z. Ct. App.) (inventory overvaluation; defendant-auditor liable, following *Hedley Byrne*, [1964] A.C. at 465); Toromont Indus. Holdings Ltd. v. Thorne, Gunn, Helliwell & Christenson, 62 D.L.R.3d 225, 247, 252 (Ont. High Ct. 1975) (auditor negligent in expressing audit opinion without audit, but insufficient evidence was presented of causal relation between negligence and substantial damages because of evidence that plaintiff would have completed acquisition anyway; following *Hedley Byrne*, [1964] A.C. at 465, and dissent in *Candler*, [1951] 1 All E.R. at 428), *modified*, 73 D.L.R.3d 122, 124 (Ont. Ct. App. 1976) (awarding plaintiff damages but only to extent of cost of new audit plus any related legal expenses).

[79] 466 F. Supp. 340 (D. Neb. 1979) (applying Nebraska and Indiana law).

[80] *Id.* at 341 (emphasis added).

attachment to the *defendant's* affidavit of notes to the financial statements prepared by the accountant. These notes disclosed that the plaintiff, in addition to being a creditor and the person responsible for the client's incorporation in Indiana,[81] held an option to purchase up to eighty percent ownership of the client. In light of these revelations, the plaintiff might well have asserted a reasonable case for being a specifically foreseen person.

The *Seedkem* court primarily cited foreseen *person* precedents and section 552 as eroding the viability of *Ultramares.*[82] The court was "doubtful that the plaintiff [would] be able to recover under the extreme circumstances presented herein."[83] Although technically denying the accountant's motion to dismiss the complaint, the court actually (and intentionally) decided nothing, by deferring the issue for discovery "to ascertain whether *any express representations* were actually made between the parties or *any understandings* existed between those involved."[84] The court suggested that the accountant reassert his motion as a motion for summary judgment according to the evidence obtained in discovery, "on the issue of the accountant's representations."[85] It is reasonable to infer from the above quotations and other language contained in the opinion that the court was applying an actually foreseen person standard of duty.

2. Specifically Foreseen Limited Class

Compared with the rather tidy group of foreseen person opinions, the foreseen class opinions are a motley assortment with an obscure message. The particular question, which is not particularly answered, is—"what is a class, and by what criteria are its limits measured"—or, "what *is not* a class and by what criteria is this determined?"

The only opinion which seems reasonable, *Haddon View Investment Co. v. Coopers & Lybrand,*[86] is rather thin in content. In that case, four individual plaintiffs were general partners of the captioned plaintiff, through which they were limited partners in two similar

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[81] *Id.* at 343.

[82] *Id.* at 342-43 (citing *Rusch,* 284 F. Supp. at 85 and *Ryan,* 170 N.W.2d at 395). The opinion also referred once to the "foreseeable" plaintiff, but in the context of the foreseen. *Id.* at 342; see *supra* note 8 and accompanying text.

[83] *Id.* at 344.

[84] *Id.* at 345 (emphasis added).

[85] *Id.* at 345 n.5.

[86] 70 Ohio St. 2d 154, 436 N.E.2d 212 (1982).

partnerships with a single identical general partner. Defendant performed auditing and other services for the latter two partnerships. The two partnerships collapsed, and their auditors were sued for alleged negligence by the Haddon View partnership and its four partners.[87] The court concluded that plaintiff-limited partners "constitute[d] a limited class of investors whose reliance on the accountant's certified audits . . . was specifically foreseen by defendant."[88] The reasoning consisted of the supposed though mistaken "rejection" of *Ultramares* in *White,* a few foreseen class precedents,[89] and section 552.[90]

One questions whether *Haddon View* should really be classified as a foreseen *person* case, and why instead the court described it as a foreseen limited *class* case. Was the *class* defined as the four limited partners because (1) they were the only limited partners, and (2) the allegedly negligent services were performed after they became partners? Or were they induced to become partners in reliance upon allegedly negligent services? Are actual partners one limited class and potential partners another, larger class? The opinion offers no clear answer to these questions.

Another case which discusses foreseen limited classes, but which throws little light on the subject, is *Merit Insurance Co. v. Colao,*[91] a diversity case governed by Illinois law. In *Merit,* a casualty insurance company sued the auditors of its defunct agent for negligence. The auditors had had reason to believe that the agent's audited financial statements might be used in an underwritten financing or organization of a new insurance company, or in the negotiation of a new agency agreement with any of numerous insurance companies, as it had with the plaintiff.[92] In ruling on motions at the pleading stage, the court declined to hold that the alleged class of insurance companies providing insurance of the kind the agent sold (which could have been much broader than casualty) was too broad or general to be an appropriately defined limited class.[93] It also declined to hold that the alleged class was too broad to satisfy the controlling Illinois precedent.

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[87] *Id.*

[88] *Id.* at 157, 436 N.E.2d at 215.

[89] *Id.* at 156, 436 N.E.2d at 214 (citing Bonhiver v. Graff, 311 Minn. 111, 248 N.W.2d 291 (1976); Hochfelder v. Ernst & Ernst, 503 F.2d 1100 (7th Cir. 1974), *rev'd on other grounds,* 425 U.S. 185 (1976)).

[90] *Id.*

[91] 603 F.2d 654 (7th Cir. 1979), *cert. denied,* 445 U.S. 929 (1980).

[92] *Id.* at 657-59.

[93] *Id.* at 659.

Under that precedent, the nonclient liability of a negligent surveyor was limited to a small group of successive owners of the surveyed land, of which only one (the plaintiff) would normally suffer loss.[94]

Finally, there is the case of *Haig v. Bamford.*[95] Although *Haig* is an opinion of the Canadian Supreme Court which cited United Kingdom and Canadian precedent, it is more oriented to (or, perhaps more accurately, disoriented by) United States law. In that case, a defendant-auditor had reason to believe that the negligently audited financial statements of his client would be furnished to the client's lenders and to prospective equity investors, one of whom proved to be the plaintiff.[96] The opinion discussed *Ultramares*, *Glanzer*, several specifically foreseen *person* opinions, section 552, and United States law commentaries.[97] After so doing, it arrived at two incongruous conclusions: (1) the defendant-auditor was aware that his client intended to furnish its audited financial statements to "a limited number of potential investors"—"a very limited class"[98]—and plaintiff was a member of that class; and (2) "the case before us is closer to *Glanzer* than to *Ultramares.*"[99]

The *Haig* court came to these conclusions despite the fact that, unlike the buyer and weigher of the beans in *Glanzer*, the plaintiff in this case was no more known to the defendant-auditor than was the *Ultramares* plaintiff to its defendant-auditor. It is the only reported judicial opinion involving accountants that applies, or purports to apply, *Glanzer* to a foreseen limited class. Moreover, the opinion furnishes no guidance on the limitation of the supposedly limited number of potential investors. Without some objective criteria for determining limitations, is it reasonable, from common experience, to describe potential investors as a very limited class? Or do such investors perhaps belong in a foreseeable class—if not the unlimited class of the public? In the apparent absence of criteria, the announced definitions of class will be affected by the differing views of the judiciary concerning the conduct of defendants.

[94] *Id.* (citing Rozny v. Marnul, 43 Ill. 2d 54, 250 N.E.2d 656 (1969)).

[95] 72 D.L.R.3d 68 (Can. 1976).

[96] *Id.* at 70.

[97] *See id.* at 75-80 (citing W. PROSSER, HANDBOOK OF THE LAW OF TORTS 706-09 (4th ed. 1971); *Rusch*, 284 F. Supp. at 85, and Rhode Island Hosp. Trust Nat'l Bank v. Swartz, Bresenoff, Yavner & Jacobs, 455 F.2d 847 (4th Cir. 1972)).

[98] *Id.* at 76, 80.

[99] *Id.* at 78.

3. Distortion of Specifically Foreseen Limited Class

The most egregious example of the application of the specifically foreseen limited class rule is the Minnesota case of *Bonhiver v. Graff*,[100] in which the term was distorted beyond recognition. The defendant-accountant in *Bonhiver* was engaged to bring the accounts of an insurance company up to date, but not to produce financial statements.[101] The defendant's employer made his workpapers available to state insurance examiners, who relied on them. The employee negligently had failed to detect a massive embezzlement by company officers (detectable from large discrepancies in intercompany account balances), which ultimately rendered the company insolvent.[102] The state insurance commissioner, as receiver of the company, was authorized by the state insurance statute[103] to sue the accountants. The commissioner was authorized to sue not only in his receiver role as successor to the client,[104] in which he would have been exposed to meritorious defenses against the client itself,[105] but as "representative" of the creditors, "agent" of the policyholders, and "agent" of the company's general agents.[106] An insurance agent who had become a general agent of the insurance company intervened in the action, seeking damages resulting from his reliance upon the commissioner's assurances (based upon defendant's representations) of the company's insolvency.[107]

The *Bonhiver* court applied what it considered to be the specifically foreseen limited class doctrine, declining to follow *Ultramares*, and choosing to follow primarily specifically foreseen *person* precedents and section 552.[108] As to the scope of the limited class, the court stated:

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[100] 311 Minn. 111, 248 N.W.2d 291 (1976).

[101] *Id.* at 115, 119, 248 N.W.2d at 295, 297.

[102] *Id.* at 115-16, 248 N.W.2d at 295-96.

[103] MINN. STAT. ANN. § 60B.04 (West Cum. Supp. 1984).

[104] For examples of suits brought by receivers of clients against accountants, see MacKethan v. Burrus, Cootes & Burrus, 545 F.2d 1388, 1389 (4th Cir. 1976) (receiver an assignee of claims by operation of law), *cert. denied*, 434 U.S. 826 (1977); Landy v. FDIC, 486 F.2d 139, 147 (3d Cir. 1973) (FDIC as both receiver and insurer-subrogee of defunct credit union), *cert. denied*, 416 U.S. 960 (1974); *In re* Hawaii Corp., 567 F. Supp. 609, 611 (D. Hawaii 1983) (bankruptcy trustee as successor-in-interest); Shapiro v. Glekel, 380 F. Supp. 1053 (S.D.N.Y. 1974) (bankruptcy trustee stands in shoes of corporation).

[105] In a case, similar to *Bonhiver*, of massive fraud by a client's management, an allegedly negligent defendant-auditor was held not liable to the client for damages. Cenco Inc. v. Seidman & Seidman, 686 F.2d 449 (7th Cir.) (Illinois law), *cert. denied*, 103 S. Ct. 177 (1982).

[106] *See Bonhiver*, 311 Minn. at 118, 126, 128, 248 N.W.2d at 296, 301, 302.

[107] *Id.* at 116, 248 N.W.2d at 295-96. The court found that "the Commissioner's [contributory] negligence was, at most, concurrent but not intervening." *Id.* at 119, 248 N.W.2d at 297.

[108] *Id.*, 248 N.W.2d at 297-99 (citing *Rusch*, 284 F. Supp. at 85, and *Ryan*, 170 N.W.2d at 395).

> As is indicated above, the extent of an accountant's liability for malpractice is not settled. If that liability is to be drawn somewhere short of foreseeability, it must be drawn on pragmatic grounds alone.
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> . . .
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> Wherever the line will eventually be drawn between those who can recover from the negligent accountant and those who cannot, we feel that on the facts of this case [intervening plaintiff-general agent] falls on the side of those who can recover.[109]

In other words, the class was to be drawn broadly enough to include the intervening plaintiffs, even though it made a travesty of the foreseen class concept.[110]

At the present time, the prevailing criterion of a negligent accountant's liability to nonclients is the specifically foreseen person and limited class test. This is sometimes expressed as an explicit avowal of section 552, and sometimes as a more liberal reinterpretation of *Ultramares* and *Glanzer*. Two recent state supreme court decisions,[111] however, have opted to expand the scope of accountant's liability to a class new to this area of the law—the class of the reasonably foreseeable.

II. THE FORESEEABLE

Apparently in anticipation of future skirmishes over foreseeability, the first reported opinions in negligence cases against accountants

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[109] *Id.* at 129-31, 248 N.W.2d at 302-03 (footnote omitted).

[110] With *Bonhiver* as the law in Minnesota, a defendant-auditor in a recent Minnesota case was obliged to go to trial on its defense of reasonable care in a negligence class action on behalf of customers of its client; the auditor, however, won a verdict from the jury. Jenson v. Touche Ross & Co., No. 737808 (Minn. D.Ct. Jan. 15, 1981), *aff'd*, 335 N.W.2d 720 (Minn. 1983) (affirmed on appeal from evidence rulings in negligence action, and on statutory counts). In another recent case, the court, in ruling on a common-law negligence claim against auditors pendent to a federal securities law class action, stated without any explanation, that "the Restatement (Second) of Torts § 552 supports liability of accountants to *public shareholders*." Zatkin v. Primuth, 551 F. Supp. 39, 46 (S.D. Cal. 1982) (emphasis added). Since the court was referring to the "entire class" of plaintiffs at whom the motion to dismiss was directed, it is impossible to rationalize that cryptic statement under § 552. The issue was the last in a very long series of preliminary motions examined and denied or granted in a single opinion. As commonly seems to happen to comparatively minor pendent common-law claims in federal securities law actions, defendant-auditor may have suffered the consequences of judicial exhaustion, or possibly the indifference that some federal judges seem to reveal toward pendent common-law counts in federal litigation.

[111] H. Rosenblum, Inc. v. Adler, 93 N.J. 324, 461 A.2d 138 (1983); Citizens State Bank v. Timm, Schmidt & Co., 113 Wis. 2d 376, 388, 335 N.W.2d 361, 367 (1983).

to endorse and apply section 552 of the *Restatement*, finding that defendant-accountants had actually foreseen plaintiff's reliance, expressly disassociated the foreseeability issue.[112] In some cases against accountants, once plaintiffs were determined to be members only of a foreseeable class rather than a specifically foreseen class, their negligence claims were dismissed forthwith. Such was the situation in suits by customers of a securities brokerage firm,[113] and by purchasers of a client's shares in a public offering and in the public over-the-counter aftermarket.[114] Consequently, prior to 1983, accountants were not held liable to plaintiffs whose reliance, though foreseeable, was not specifically foreseen.[115] In that year, however, the New Jersey Supreme Court in *H. Rosenblum, Inc. v. Adler*[116] took a different view.

The plaintiffs in *Rosenblum* alleged negligence by the auditor in failing to detect a large-scale management fraud[117] when auditing its

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[112] *Rusch*, 284 F. Supp. at 93 ("The Court . . . leaves open for reconsideration . . . the question of whether an accountant's liability for negligent misrepresentation ought to extend to the full limits of foreseeability"); *Ryan*, 170 N.W.2d at 403 ("It is unnecessary at this time to determine whether the rule of no liability should be relaxed to extend to all *foreseeable persons* who may rely upon the report, but we do hold it should be relaxed as to those who were actually known to the author as prospective users of the report and take into consideration the end and aim of the transaction." (emphasis added)).

[113] Hochfelder v. Ernst & Ernst, 503 F.2d 1100, 1107 (7th Cir. 1974) (negligence claim under Illinois law pendent to federal securities law action; no specific discussion of foreseeability), *rev'd on other grounds*, 425 U.S. 185 (1976).

[114] Shofstall v. Allied Van Lines, Inc., 455 F. Supp. 351, 359-60 (N.D. Ill. 1978) (negligence claim under Illinois law pendent to § 10(b) and rule 10b-5 action under Securities Exchange Act of 1934, 15 U.S.C. § 78j (1982) and 17 C.F.R. § 240.10b-5 (1983), respectively; following Hochfelder v. Ernst & Ernst, 503 F.2d 1100, 1107 (7th Cir. 1974), *rev'd on other grounds*, 425 U.S. 185 (1976); no specific discussion of foreseeability nor of investors in public market); Denbeste v. Meriwether, Wilson & Strick, No. 74-35-D, slip op. at 4-5 (S.D. Iowa Sept. 2, 1981) (negligence claim under Iowa law pendent to federal securities law action; foreseeability discussed; following *Ryan*, 170 N.W.2d at 395).

[115] One exception to this is California, which appears to be receptive to the notion of the foreseeability standard. *See* Weiner, *supra* note 2, at 233 n.1 (citing Swiss Bank Corp. v. Touche Ross & Co., No. 161 (Cal. Super. Ct. Nov. 29, 1977) (verdict for plaintiff on court's instruction which included negligence and foreseeability standard), *settled pending appeal*, Swiss Bank Corp. v. Touche Ross & Co., No. 18057 (Cal. Ct. App. stipulated reversal June 1980)). See also CAL. CIV. CODE § 1572(2) (West 1982); *id.* § 1710(2) (West 1973), in which negligent misrepresentations (such as negligently issued audit opinions), but not negligent omissions or acts, are defined in effect as forms of fraud or deceit without scienter.

[116] 93 N.J. 324, 461 A.2d 138 (1983).

[117] The repercussions of the management fraud were considerable as evidenced by the litigation which ensued: (1) claims of $100 million in eight lawsuits against the defendant-auditors, H. Rosenblum, Inc. v. Adler, 183 N.J. Super. 417, 422, 444 A.2d 66, 68 (App. Div. 1982), *aff'd in part, rev'd in part*, 93 N.J. 324, 461 A.2d 138 (1983); (2) administrative censure of the auditor (with the auditor's consent) by SEC finding a failure to meet certain generally accepted auditing standards established by the profession relating to the audit of the 1972 financial statements, SEC Accounting Series Release (ASR) No. 153A, [7 Transfer Binder] FED. SEC. L. REP. (CCH) ¶

client's 1971 and 1972 financial statements.[118] The two individual plaintiffs also alleged reliance on the audited financial statements in selling their businesses to the client in exchange for shares of the client which became worthless after the fraud was discovered. The trial court entered partial summary judgment in favor of the defendant-auditor as to the 1971 audit, but not as to the 1972 audit.[119]

On appeal, the Appellate Division of the New Jersey Superior Court faced facts and applied legal reasoning similar to that applied in other accountants' liability cases. The court discussed the retreat by most jurisdictions from the strict privity of contract defense of *Ultramares*, cited approvingly the specifically foreseen person cases of more recent years, discussed section 552, and concluded that:

> We are of the view that the moderate rule as expressed in § 552 of the *Restatement, Torts* 2d is the better view and we adopt it. We hold that the liability of an accountant for negligence is to be measured by a duty owed to one with whom he is in privity or one of a limited group of persons for whose benefit and guidance he intends to supply the information or to whom he knows the recipient of his report will supply it. However, even under this rule

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72,175A, at 62,363-3 (1979); (3) criminal indictment and conviction of several of the client's officers; *see* United States v. Kaufman, No. 77-135-S (D. Mass. Apr. 20, 1977); United States v. Lieberman, [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,167 (1st Cir. 1979).

[118] *Rosenblum*, 93 N.J. at 331, 461 A.2d at 141. The events leading to the suit began in November 1971 when the auditor's client began negotiations with the plaintiffs for the acquisition of the plaintiffs' businesses. One month later the client made a public offering of its shares. The prospectus of that offering included financial statements for the four years ending January 30, 1971. To each statement was affixed the auditor's unqualified opinion. *Id.* at 330, 461 A.2d at 141. The plaintiffs, allegedly in reliance on the financial statements, subsequently agreed to merge their businesses into the client in exchange for shares of the client. During the same period, the auditor had commenced an audit of the client's financial statements for the year ending January 29, 1972. *Id.* These audited financial statements, also accompanied by unqualified audit opinions, were issued in April 1972, and the merger was completed in June 1972. Eight months later, it was revealed that the client had falsified its accounts, thus making it apparent that the 1971 and 1972 financial statements were misstated. News of the fraud led to the suspension and ultimate termination of trading in the client's stock. By September 1973 the client had filed a petition in bankruptcy and as a result the plaintiffs' shares in the client became worthless. *Id.* at 331, 461 A.2d at 141.

In addition to their allegation of negligence, the plaintiffs also charged the auditor with fraudulent misrepresentation, gross negligence, and breach of warranty in their audits of the 1971 and 1972 financial statements. *Id.* at 332, 461 A.2d at 141.

[119] The trial court ruled that the auditor could not be found liable for negligence in the 1971 audit because it was not aware of the existence of the plaintiffs at the time of the audit. *Id.* at 353, 461 A.2d at 153-54. As to the 1972 audit, the trial court found that the auditors had knowledge of the merger agreement and that it had been employed by the client to conduct the audit for the purpose of the merger. *Id.* at 356-57, 461 A.2d at 155-56.

> plaintiffs must fail. It is conceded that the merger was not contemplated for at least seven months after defendants' 1971 report was completed and filed. When defendants prepared that 1971 audit there was no suggestion that plaintiffs or any one of a similar limited group would place reliance upon it for merger purposes.[120]

Accordingly, the appellate court affirmed partial summary judgment for the defendant-auditor on the negligence count in connection with the 1971 audit.[121] Since it had denied defendant's motion for leave to appeal the trial court's denial of partial summary judgment in connection with the 1972 audit, the lower court's ruling in that respect remained intact.

The New Jersey Supreme Court reversed in part, departing from precedent by applying the reasonably foreseeable test against the defendant-auditor.[122] The court ruled adversely on defendant's motions for summary judgment on the allegations of negligence in defendant's audits of both the 1971 and 1972 financial statements, reversing summary judgment on the 1971 audit, and affirming the trial court's denial of summary judgment on the 1972 audit.[123] As might be expected, the court issued a somewhat lengthy opinion in explanation of its departure from precedent.

In addressing the issue of the auditor's duty, the court cited the following three principal terms: (1) privity or "known beneficiaries," attributed to *Ultramares*; (2) "a known and intended class of beneficiaries," citing section 552; and (3) reasonable foreseeability of reliance by the recipients of the audited financial statements.[124] In connection with the third term, the court cited the recent United Kingdom decision in *JEB Fasteners Ltd. v. Marks, Bloom & Co.*,[125] in which a negligent defendant-auditor had been held liable to a plaintiff whose reliance was found to have been reasonably foreseeable. In other parts of the opinion, the court gave weight to additional United Kingdom-Commonwealth opinions and to one English law review article.[126] Citation of those authorities is highly significant, because

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[120] H. Rosenblum, Inc. v. Adler, 183 N.J. Super. 417, 424, 444 A.2d 66, 70 (App. Div. 1982), *aff'd in part, rev'd in part*, 93 N.J. 138, 461 A.2d 138 (1983).

[121] *Id.*

[122] *Rosenblum*, 93 N.J. at 352-53, 461 A.2d at 153.

[123] *Id.* at 351, 461 A.2d at 156.

[124] *Id.*

[125] [1981] 3 All E.R. 289 (Q.B.), *cited in Rosenblum*, 93 N.J. at 333, 352 n.14, 461 A.2d at 142, 153 n.14; see *infra* notes 208-16 and accompanying text.

[126] *Rosenblum*, 93 N.J. at 350-52 nn.12-14, 461 A.2d at 152-53 nn.12-14 (citing, e.g., Scott Group Ltd. v. McFarlane, [1978] 1 N.Z.L.R. 553 (N.Z. Ct. App. 1977) (discussed *infra* notes 195-207); Stanton & Dugdale, *Recent Developments in Professional Negligence—II: Accountant's Liability to Third Parties*, 132 NEW L.J. 4 (1982)).

neither plaintiffs nor defendant had briefed or argued them or any other United Kingdom-Commonwealth authorities.

The court used familiar language and references in dealing with *Ultramares* and the bean weighers' case.[127] It turned to the general rule imposing liability for the reasonably foreseeable consequences of negligence[128] as a prelude to discussing with approval its products liability decisions awarding damages for both physical and economic injury without a requirement of privity.[129] The court then proceeded to analogize the negligent manufacture of a product to the negligent issuance of an audit opinion:

> Why should a claim of negligent misrepresentation be barred in the absence of privity when no such limit is imposed where the plaintiff's claim also sounds in tort, but is based on liability for defects in products arising out of a negligent misrepresentation? If recovery for defective products may include economic loss, why should such loss not be compensable if caused by negligent misrepresentation?[130]

In this respect, the court's reasoning is grievously flawed. Courts tend to become so taken with the similarities of an analogy that they overlook the fact that the differences inherent in an analogy sometimes outweigh those similarities.[131] A business enterprise has control over, and responsibility for, the methods both by which it manufactures products and by which it maintains its accounting records. It may or may not perform those processes adequately, but it *controls* them, and no one else does. The independent auditor does not control the *client's* accounting records and processes. In conformity with

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[127] *Id.* at 337-39, 461 A.2d at 144-45. Also, the court cited once, *id.* at 337 n.3, 461 A.2d at 144 n.3, but otherwise ignored, the single judicial opinion construing New Jersey law on auditors' liability to nonclients, in Coleco Indus., Inc. v. Berman, 423 F. Supp. 275, 308-10 (E.D. Pa. 1976), *aff'd in part, remanded in part on other grounds*, 567 F.2d 569 (3d Cir. 1977), *cert. denied*, 439 U.S. 830 (1978). Significantly, the specifically foreseen person test of duty was applied. *Coleco*, 423 F. Supp. at 310.

[128] *Rosenblum*, 93 N.J. at 339, 461 A.2d at 145.

[129] *Id.* at 339-41, 461 A.2d at 145-47 (citing Santor v. A&M Karagheusian, Inc., 44 N.J. 52, 207 A.2d 305 (1965) (economic injury; no privity); Martin v. Bengue, Inc., 25 N.J. 359, 136 A.2d 626 (1957) (physical injury; no privity); O'Donnell v. Asplundh Tree Expert Co., 13 N.J. 319, 99 A.2d 577 (1953) (same)).

[130] *Id.* at 341, 461 A.2d at 147.

[131] *See* Spherex, Inc. v. Alexander Grant & Co., 122 N.H. 898, 904, 451 A.2d 1308, 1312 (N.H. 1982) (like *Rosenblum* court, also taking products liability analogy for granted in case against accountants). *But see* Minow, Special Report: Accountants Liability (Arthur Anderson & Co. 1984) (noting fallacy of accountants' liability-product liability analogy).

professional auditing standards, the auditor tests and analyzes the financial statements that are the end result of the client's accounting processes (whatever their infirmities), with a view toward expressing his professional opinion on their quality. According to his findings, the auditor recommends adjustments of the client's financial statements, and when occasion requires, he insists on adjustments prior to issuing an audit opinion satisfactory to the client. The auditor, however, is an outsider; he is never as close to the accounting processes as the client's general and accounting officers who govern these processes.[132]

Following its product liability comparison the court discussed at some length the fairness, from a public interest perspective, of imposing a duty of foreseeability on accountants.[133] In this regard, the court attempted to minimize the continuing reliance on *Ultramares*, invoking a revisionist theory appearing in some of the literature[134] to the effect that *Ultramares* is a relic from an age in which an "audit was made primarily to inform management of irregularities and inefficiencies in the business."[135] According to the court, the audit has *since* evolved to meet, in addition, the needs of investors, lenders, suppliers, and the government.[136] The court's description of this as a post-*Ultramares* development is refuted in the very text of the *Ultramares* opinion, in which Chief Judge Cardozo recognized the potential for the audit to be used in a variety of related transactions. Regarding the client, the Chief Judge wrote:

> To finance its operations, it required extensive credit and borrowed large sums of money from banks and other lenders. All this was known to the defendants. The defendants knew also that in the usual course of business the balance sheet when certified would be exhibited by the [client] to banks, creditors, stockholders, purchasers, or sellers, according to the needs of the occasion, as the

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[132] Although in matters of adequate financial statement disclosure of what is known to auditor and client alike, rather than of what and how much is reasonably determinable by the auditor through adequate testing and analysis, the auditor, as an expert professional, has a responsibility commensurate with that of the client in requiring adequate disclosure as a condition of issuance of a favorable audit opinion. *See* Herzfeld v. Laventhol, Krekstein, Horwath & Horwath, 540 F.2d 27 (2d Cir. 1976).

[133] *Rosenblum*, 93 N.J. at 341-53, 461 A.2d at 147-53. See *infra* notes 218-34 and accompanying text for a further discussion of the court's treatment of the fairness issue, including the extent of the burden on professional accountants of exposure to such a degree of liability, and the insurability of the risk.

[134] *Rosenblum*, 93 N.J. at 345-46, 461 A.2d at 149; *see* Spherex, Inc. v. Alexander Grant & Co., 122 N.H. 898, 903-04, 451 A.2d 1308, 1311-12 (1982) (auditor-defendant; modern accounting profession no longer in need of judicial protection provided by *Ultramares* to a then "fledgling profession").

[135] *Rosenblum*, 93 N.J. at 345, 461 A.2d at 149.

[136] *Id.* at 345-47, 461 A.2d at 149-50.

> basis of financial dealings . . . . The range of the transactions in which a certificate of audit might be expected to play a part was as indefinite and wide as the possibilities of the business that was mirrored in the summary.[137]

Consequently, the court's attempt to characterize the fairness of expanding the scope of accountant's liability as a function of modern developments in the use of the audit opinion is erroneous.

In a similarly unconvincing attempt to justify its reasoning, the court suggested that "[t]he accounting firm could seek indemnification or contribution from the company and those blameworthy officers and employees."[138] As a practical matter, the very case over which the court was presiding was representative of many and possibly most such circumstances, that is, those in which legal recourse would yield little or no financial recompense. Apparently nothing in the record of the case drew the court's attention to the fact that negotiation by an auditor of a contractual right of indemnification by or on behalf of the client would disqualify the auditor from serving as *independent* auditor of the client.[139] A contractual right of contribution would probably have the same result, since contribution is akin to indemnification. Moreover, federal courts, although generally receptive to tort contribution, have uniformly denied indemnification in federal securities law cases.[140] Therefore, the court's suggestion is not really feasible.

The opinion also suggested the availability of disclaimers of liability and restrictions on the use of and reliance on audit opinions "in some circumstances, such as when auditing a privately owned company."[141] The suggestion is impractical for professional accountants, even though some other professionals, such as lawyers, can occasionally disclaim or limit reliance and responsibility in opinions in private transactions. In any case, those tactics and others, such as diluting the substance of audit opinions, would be attended with social disutilities that would make them unattractive to the court and to everyone else.

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[137] *Ultramares*, 255 N.Y. at 173-74, 174 N.E. at 442.

[138] *Rosenblum*, 93 N.J. at 351, 461 A.2d at 152.

[139] SEC, Codification of Financial Reporting Policies § 602.02i.i, 5 FED. SEC. L. REP. (CCH) ¶ 73,274 at 62,913 (originally, Accounting Series Release No. 22 (1941)).

[140] For additional discussion of indemnity and contribution in federal securities law cases, see R. GORMLEY, THE LAW OF ACCOUNTANTS AND AUDITORS ¶¶ 12.03, 12.04 (1981).

[141] *Rosenblum*, 93 N.J. at 351, 461 A.2d at 152 (citing *Hedley Byrne*, [1964] A.C. at 465, in which bank avoided liability for negligence by disclaiming responsibility in furnishing credit information without charge).

In addition, the relevance of the suggestion in a controversy involving a publicly owned company is obscure.

Finally, the *Rosenblum* court seriously underestimated the scope of foreseeable plaintiffs to whom an auditor would in all probability be exposed for negligence:

> Thus, for example, an institutional investor or portfolio manager who does not obtain audited statements from the company would not come within the stated principle. Nor would stockholders who purchased the stock after a negligent audit be covered in the absence of demonstrating the necessary conditions precedent. Those and similar cases beyond the stated rule are not before us and we express no opinion with respect to such situations.[142]

This overly-bold conjecture is prudently hedged with the final sentence of disclaimer. The statement fails to take into account the characteristic thoroughness of institutional investors, aided by counsel, in obtaining documentation, including financial statements and audit opinions, that would support a strong case that the investors' reliance on the audit opinions was actually foreseen by the auditors. Resourceful counsel can be expected to make admirably persuasive appeals that all of their respective clients—shareholders, debenture-holders, suppliers, customers, and possibly tax-gatherers and other government bodies as well—justifiably relied either on the financial statements and audit opinion received by them or seen by them, or on the knowledge in the community of the company's apparent solidity, attested to by its financial statements and auditor's opinion.[143] Indeed, the *Rosenblum* court subsequently pointed out a number of uses that the defendant-auditor should have known would (or might) be made of its audit opinion, among them obtaining credit, and that a copy would be sent to each shareholder with the financial statements. The court observed that "[t]hese were clearly foreseeable potential uses of the audited financials at the time of their preparation."[144] Such a statement illustrates the internal inconsistency of the court's conception of the scope and limitations of foreseeability, and the confusion that courts will be forced to endure in future attempts to apply the standard.

Although one might have expected the opinion to conclude at that point, the court evidently felt the need to justify its denials of

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[142] *Id.* at 352-53, 461 A.2d at 153.

[143] As to the latter, compare the "fraud-on-the-market" opinions in some of the federal securities law cases, starting with Blackie v. Barrack, 524 F.2d 891, 906 (9th Cir. 1975) (co-defendant-auditor), *cert. denied*, 429 U.S. 816 (1976).

[144] *Rosenblum*, 93 N.J. at 355, 461 A.2d at 154.

summary judgment by offering a review of the relevant allegations and other facts then in contention concerning the audits of the 1971 and 1972 financial statements.[145] Two important points in the court's own summation, however, suggest that consideration of the foreseeability issue may have been unnecessary, and that the court might reasonably have supported its denial on a theory that the two individual plaintiffs, who merged their businesses into defendant's client in exchange for its shares, were in fact specifically foreseen persons.

First, although negotiation of the merger did not commence until six months after completion of the 1971 audit, defendant's audit engagement partner was present at the merger negotiations, and participated in them.[146] United States opinions appear to reject the proposition that a duty to specifically foreseen persons may arise so belatedly,[147] but there exists Commonwealth precedent that a "special relationship" is established upon contact between an auditor of the client's business and a purchaser of the business,[148] even though the contract is subsequent to the audit, provided it is prior to the purchase.

Second, although the merger agreement in *Rosenblum* had been signed and delivered before the 1972 financial statements and audit opinion were issued, the agreement contained a customary representation, warranty, and condition of closing that there would be no material adverse change in the acquiring client's business, property,

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[145] *Id.* at 353-57, 461 A.2d at 153-56.

[146] *Id.* at 353-56, 461 A.2d at 153-55.

[147] Koch Indus., Inc. v. Vosko, 494 F.2d 713, 725 (10th Cir. 1974) (plaintiff-purchaser of stock of client not specifically foreseen person, because audit had been performed for earlier proposed purchaser); Briggs v. Sterner, 529 F. Supp. 1155, 1177 (S.D. Iowa 1981) ("the risk to be perceived *at the time of the undertaking* defines the nature of the duty of ordinary care owed to third parties" (emphasis added)); Denbeste v. Meriwether, Wilson & Strick, No. 74-35-D (S.D. Iowa Sept. 2, 1981) (following *Ryan*, 170 N.W.2d at 395, and *Koch*, 494 F.2d at 713, in negligence claim under Iowa law pendent to federal securities law action); *Ryan*, 170 N.W.2d at 403 (duty of care to specifically foreseen person, "especially when the party to be benefitted is identified before the statement or report is submitted by the accountant").

[148] Dimond Mfg. Co. v. Hamilton, [1969] N.Z.L.R. 609, 629 (N.Z. Ct. App.) (special relationship created under *Hedley Byrne* when previously audited financial statements were shown by partner of negligent auditor to plaintiff at client's request for reliance in purchase of client; court ruled that tort is complete only when acted upon by representee); Toromont Indus. Holdings Ltd. v. Thorne, Gunn, Helliwell & Christenson, 62 D.L.R.3d 225, 247 (Ont. High Ct. 1975) (relationship created by personal contact after completion of audit but before closing of acquisition of client in which negligently audited financial statements were used in determining purchase price), *modified*, 73 D.L.R.3d 122 (Ont. Ct. App. 1976); *cf.* JEB Fasteners Ltd. v. Marks, Bloom & Co., [1980] 3 All E.R. 289 (Q.B.) (similar to *Dimond* on facts, but finding of duty based on foreseeability theory).

or assets prior to the time of closing, which was after the time of issuance.[149] Subject to evidence on disputed factual issues, the court considered it reasonably foreseeable that plaintiffs would rely in part on the audited financial statements in consummating the merger.[150] The court's own statement again suggests that the plaintiffs may have been specifically foreseen persons, and one must question whether the trial court may also have concluded this in its denial of summary judgment on the 1972 audit which the supreme court affirmed.

The essential facts are as follows: the defendant based its brief and argument on *Ultramares*; the plaintiffs based their brief and argument on section 552; the court, of its own accord, researched the United Kingdom-Commonwealth precedents, and as a consequence based its argument upon foreseeability. The court, of course, won the argument.

Less than a month after issuance of the *Rosenblum* opinion, the Wisconsin Supreme Court in *Citizens State Bank v. Timm, Schmidt & Co.*[151] also denied summary judgment to a defendant-auditor and its insurer, on negligence allegations by a lender to the auditor's client. In a more prosaic opinion than *Rosenblum*, the court began by disposing of *Ultramares*. It pointed to the trend toward elimination of a privity requirement, and cited the specifically foreseen person cases of *Rusch*, *Ryan*, and a recent Wisconsin decision holding a negligent attorney liable to a beneficiary of the will of his deceased client.[152]

The court also quoted and discussed section 552, but regarded its scope as too restrictive to be compatible with a general Wisconsin rule that makes no distinction between negligent acts and negligent misrepresentations. The court simply stated that "a tortfeasor is fully liable for all foreseeable consequences of his act except as those consequences are limited by policy factors."[153] Accordingly, the court, citing the *Rosenblum* decision for additional support, found that the defendant-auditors could be held liable for the foreseeable conse-

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[149] *Rosenblum*, 93 N.J. at 356-57, 461 A.2d at 155; *accord* Toromont Indus. Holdings Ltd. v. Thorne, Gunn, Helliwell & Christenson, 62 D.L.R.3d 225, 247 (Ont. High Ct. 1975), *modified*, 73 D.L.R.3d 122 (Ont. Ct. App. 1976).

[150] *Rosenblum*, 93 N.J. at 356-57, 461 A.2d at 155-56.

[151] 113 Wis. 2d 376, 388, 335 N.W.2d 361, 367 (1983). A Wisconsin statute gives an injured person a direct right of action against a negligence insurer, in common with a few other jurisdictions and in reversal of the general common-law rule. WIS. STAT. ANN. § 632.24 (West 1980). The result is a tendency to prejudice both the alleged tortfeasor and co-defendant insurer, especially in a jury case.

[152] *Citizens State Bank*, 113 Wis. 2d at 383-84, 335 N.W.2d at 364-65 (citing Auric v. Continental Casualty Co., 111 Wis. 2d 507, 331 N.W.2d 325 (1983)).

[153] *Id.* at 386, 335 N.W.2d at 366.

quences of their negligent misrepresentations, as long as public policy did not dictate otherwise.[154]

Among the public policy reasons for not imposing liability despite negligence, the court mentioned the disproportion of the injury to culpability and the potential for imposing unreasonable burdens on the defendant.[155] It failed, however, to evaluate the relevance of public policy questions in the case, because it is Wisconsin practice to defer consideration of public policy questions until after full development of the facts at trial of the negligence issue.[156] Accordingly, the court remanded the case for trial.

III. Beyond the Foreseeable—The Unlimited Class of the Public

Courts have not ruled directly on the issue of whether a negligent accountant may be held liable to persons who are members of the general public, but whose reliance is not reasonably foreseeable to the accountant. Some courts, however, appear to have attempted to draw a distinction between these two classes. In an action by potential investors in a public offering of securities, one court stated that "plaintiffs are members of a potentially unlimited class of investors in defendants' client which could not reasonably have been ascertained by the defendant accountants when the latter agreed to render accounting services to [their client]. . . ."[157] Similarly, in a case in which the defendant-auditor did not know of the prospect of subsequent investment by plaintiffs in the client, the court summed up the distinction as follows:

> We are of the opinion that the lack of privity is not a defense where an accountant . . . is aware of the fact that his work will be relied on by a party or parties who may extend credit to his client or assume his client's obligations. A future purchaser of shares of stock of a corporation, however, belongs to an *unlimited class* of equity holders who could not be reasonably foreseen as a third party who would be expected to rely on a financial statement prepared by an accountant for the corporation.[158]

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[154] *Id.*

[155] *Id.* at 387, 335 N.W.2d at 366.

[156] *Id.*, 335 N.W.2d at 366-67.

[157] Briggs v. Sterner, 529 F. Supp. 1155, 1177 (S.D. Iowa 1981) (negligence claim under Iowa law, pendent to federal securities law action).

[158] Milliner v. Elmer Fox & Co., 529 P.2d 806, 808 (Utah 1974) (emphasis added) (footnotes omitted).

Also, in another suit against auditors, the court held that plaintiff-sureties on a construction contract were "merely members of the public" in relying on the contractor's audited financial statements.[159]

Nevertheless, these decisions fail to establish a distinction between the foreseeable class and the class of the general public. The obscurity of the distinction is illustrated by successive lower and appellate court opinions in a New Zealand case.[160] In that case the defendant-auditor, who had been negligent in its audit of a publicly owned client, was unaware at the time of his audit that the plaintiff was preparing to purchase all of the client's shares in reliance on various published data, including the client's audited financial statements published and filed in a government office pursuant to statute.[161] The lower court regarded the plaintiff as a member of the public, and declined to accept the argument that anyone dealing in the public market in shares of a publicly owned company in reliance on its financial statements could claim a special relationship with negligent auditors of the company.[162] In reversing the lower court, all three members of the court of appeals concluded that transactions such as the plaintiff's should have been reasonably foreseeable to the auditors.[163]

The distinction between a reasonably foreseeable class and the general public became blurred in an opinion concerning plaintiff "general investors," who invested in defendant-auditor's client in alleged reliance upon the audited financial statements in the client's prospectus.[164] The court first stated that plaintiffs were "merely forseeable [sic] at the time the statements were examined,"[165] and were not " 'actually foreseen and limited classes of persons' "[166] entitled to recourse against a negligent auditor. Having determined that there was no liability, the court then proceeded to obscure the distinction between foreseeable persons and the general public by lumping the two groups together and observing that a broader interpretation of

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[159] Dworman v. Lee, 83 A.D.2d 507, 507, 441 N.Y.S.2d 90, 91 (App. Div. 1981), *aff'd mem.*, 56 N.Y.2d 816, 438 N.E.2d 103, 56 N.Y.S.2d 816 (1982).

[160] Scott Group Ltd. v. McFarlane, [1975] 1 N.Z.L.R. 582 (N.Z.S.C.), *aff'd on other grounds*, [1978] 1 N.Z.L.R. 553 (N.Z. Ct. App. 1977).

[161] *Id.* at 586; Scott Group Ltd. v. McFarlane, [1978] 1 N.Z.L.R. 553, 556 (N.Z. Ct. App. 1977).

[162] *Scott Group*, [1975] 1 N.Z.L.R. at 587, 590.

[163] Scott Group Ltd. v. McFarlane, [1978] 1 N.Z.L.R. 553, 566, 575, 582 (N.Z. Ct. App. 1977).

[164] Denbeste v. Meriwether, Wilson & Strick, No. 73-35-D (S.D. Iowa Sept. 2, 1981).

[165] *Id.* slip op. at 4.

[166] *Id.* (quoting *Ryan*, 170 N.W.2d at 402).

liability "would subject an accountant to suits initiated by investors whom he or she could not reasonably have contemplated at the time a financial statement was compiled or examined on behalf of the clients/issuer."[167] The court concluded that there was "not . . . a duty of care on the part of accountants to a potentially *unlimited* class of investors in a corporate client."[168]

In support of a foreseeability standard of responsibility, it has been suggested that such a standard would eliminate the difficulties in distinguishing between the specifically foreseen and the reasonably foreseeable.[169] This suggestion, however, ignores the reality that all of the terms discussed above—end and aim, primary beneficiary, specifically (or actually or known) foreseen person, foreseen limited class, reasonably foreseeable class, and unlimited class or the public—are labels attached to a continuum of behavior that blends together by infinity of degree. There has been little judicial examination thus far of the distinction between the reasonably foreseeable class and the unlimited class or public, because until recently there has been no legal need to make the distinction. The opinions cited above evidence this indistinctness. Drawing a distinction between the reasonably foreseeable class and the unlimited class of the public could well prove more difficult than discerning a distinction between the specifically foreseen and reasonably foreseeable classes. It is complicated by the fact that, in the face of the void created, plaintiffs could be expected to argue that the reasonably foreseeable class is unlimited.

IV. United Kingdom and Commonwealth Decisions

In this area of law, United States and United Kingdom-Commonwealth decisions each have been influenced perceptibly by the other, perhaps more than many United States lawyers realize. Some of the important United Kingdom-Commonwealth opinions have been influenced by *Ultramares*, *Glanzer*, section 552, and specifically foreseen person opinions.[170] Likewise, some of the influential United

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[167] *Id.* slip op. at 5.

[168] *Id.* (emphasis added).

[169] Note, *supra* note 2, at 608.

[170] *E.g.*, Donaghue v. Stevenson, [1932] A.C. 562 (H.L.). In *Donaghue*, a justice stated: "It is always satisfaction to an English lawyer to be able to test his application of fundamental principles of the common law by the development of the same doctrines by the lawyers of the courts of the United States." *Id.* at 598 (citing with approval "the illuminating judgment of Cardozo, C.J." in MacPherson v. Buick Motor Co., 217 N.Y. 382, 111 N.E. 1050 (1916)). *MacPherson* and an earlier New York products liability opinion were approved in another majority opinion, *id.* at 617, but were distinguished in a dissenting opinion as "dangerous article" cases. *Id.* at 577.

States opinions have drawn support from *Hedley Byrne* and the *Candler* dissent. Perhaps most significantly, *Rosenblum* reveals the influence of recent United Kingdom and Commonwealth opinions that subject accountants to a duty of care to those whose reliance is reasonably foreseeable.

There are problems in achieving adequate understanding of the character and background of authority in foreign jurisdictions. One problem, visible on the surface, is communication—inadequate awareness of the resources of other common-law jurisdictions, and difficulty of access to and maintenance of the increasingly massive library materials of the various jurisdictions.[171] Other difficulties arise from different meanings and nuances of words in a common language, especially those words and expressions that have become terms of art in some jurisdictions, but merely appear to be conversational in others. Differing modes of thought, expression, and reference present difficulties in interpretation. Political, social, and economic differences can make it equally difficult to grasp context and background adequately. Accordingly, United States lawyers experience difficulty in synthesizing accurately the conclusions implied or expressed in different ways in the seriatim opinions of justices in the highest United Kingdom and Commonwealth courts.

The *Hedley Byrne* opinions[172] are illustrative. There, the defendant bank gratuitously, but negligently, furnished inaccurate credit information concerning one of its customers to a second bank. The plaintiff, a customer of the second bank, relied on the misinformation in extending credit, to its loss.[173] The case has been known in the United States for the justices' description of the terms "special relationship" and "special duty," which United States lawyers have tended to regard as an equivalent of the specifically foreseen person and limited class generality of the *Restatement*.[174] The matter, however, proves to be far more complex.

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[171] The inefficiencies in communication reveal themselves in varying degree in judicial opinions from both the United States and United Kingdom. *See, e.g.*, Hochfelder v. Ernst & Ernst, 503 F.2d 1100, 1107 (7th Cir.), *rev'd on other grounds*, 425 U.S. 185 (1974) (relying on the *Candler* majority 11 years after its express disapproval); Grover Indus. Holdings, Ltd. v. Newman Harris & Co. (Jan. 12, 1976) (unreported) (discussed in JEB Fasteners Ltd. v. Marks, Bloom & Co., [1981] 3 All E.R. 289 (Q.B.), *aff'd*, [1983]1 All E.R. 583 (C.A.) (trial court in 1976 case considered itself precluded from its preferred conclusion by *Ultramares*, 255 N.Y. at 170, 174 N.E. at 441, and other opinions which were unnamed)).

[172] *Hedley Byrne*, [1964] A.C. at 465.

[173] *Id.* at 469.

[174] RESTATEMENT (SECOND) OF TORTS § 552, comment h, illustration 11, at 135-36 (1977) (illustration contains the *Hedley Byrne* facts except for the absence of a disclaimer of liability);

United States lawyers have tended to criticize the diffuse opinions in *Hedley Byrne* as failing to communicate any clear message.[175] To the contrary, a patient study of the long and multiple opinions in *Hedley Byrne* and in other United Kingdom-Commonwealth negligence appeals cases reveals a conception of duty that is reasonably coherent, but is different in articulation and to some degree in content from that of the *Restatement*, and therefore is not so readily recognizable to United States lawyers.

First, the modes of thought and expression are different. The terms "special relationship" and "special duty," which seem so pallid and uninformative in the abstract, absorb meaning and color in the context of illustration and metaphor. They derive still more meaning when associated in a specific manner with other terms in the context of *their* illustration and metaphor. Second, recent United Kingdom-Commonwealth opinions reveal that, unlike the *Restatement* rules which have broad and general applicability, the content of those terms is affected in different cases by the facts in each individual controversy.

In recognition of those observations, a study of *Hedley Byrne* shows that the number of references to a special relationship and special duty is exceeded by the number of references to "proximity," which in turn is occasionally associated with the homely and seemingly conversational term "neighbour." All of those expressions gradually emerged, in *Hedley Byrne* and other opinions, as legal terms of art, with a body of meaning that is well understood by United Kingdom-Commonwealth jurists and practitioners.

Some of the statements in *Hedley Byrne* amplify the terms "special relationship" and "duty." For example, "special relationships . . . include . . . relationships which . . . are 'equivalent to contract'[;] that is, where there is an assumption of responsibility in circumstances in which, but for the absence of consideration, there would be a contract."[176] Also:

> [I]f . . . where a person is so placed that others could reasonably rely on his judgment or his skill . . . such person takes it on himself to give information or advice to, or allows his information or advice to be passed on to, another person who, as he knows, or

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Rhode Island Hosp. Trust Nat'l Bank v. Swartz, Bresenoff, Yavner & Jacobs, 455 F.2d 847, 851 (4th Cir. 1972).

[175] *See supra* note 35 and accompanying text.

[176] *Hedley Byrne*, [1964] A.C. at 528-29.

should know, will place reliance on it, then a duty of care will arise.[177]

And: "[It is] not . . . possible to catalogue the special features which must be found to exist before the duty of care will arise in a given case . . . ."[178]

Other statements discuss the terms "proximity" and "neighbour" in relation to special relationships and duty. One of the justices defined the "principle of proximity" as holding that: "You must take reasonable care to avoid acts or omissions which you can *reasonably foresee* would be likely to injure your neighbour."[179] Another spoke of the "degree of proximity necessary to establish a [special] relationship giving rise to a duty of care."[180] A third said that "special relationship [is] derived . . . from the notion of proximity . . . or from those . . . possessing a special skill [, who] are under a duty to exercise it with reasonable care."[181] Further, professionals "have a duty of skill and care. In terms of proximity one might say that they are . . . particularly close . . . to those who, as they know, are relying on their skill and care, although the proximity is not contractual."[182]

Additional statements emphasize the fluidity and factual orientation of the duty concept. "[T]he law can be developed to solve particular problems. Is the relationship between the parties in this case such that it can be brought within a category giving rise to a special duty?"[183] Quoting a celebrated 1932 products liability decision, a justice stated that: " 'The categories of negligence are never closed.' English law is wide enough to embrace any new category or proposition that exemplifies the principle of proximity."[184]

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[177] *Id.* at 514.

[178] *Id.*

[179] *Id.* at 524 (emphasis added). The dissenting opinion in *Candler*, [1951] 1 All E.R. at 426, also speaks of "proximity," *id.* at 434, and "close and direct," *id.* at 428, 433.

[180] *Hedley Byrne*, [1964] A.C. at 488.

[181] *Id.* at 505 (citing Heaven v. Pender, 11 Q.B.D. 503 (1883) (Lord Esher, M.R.), as origin of concept of proximity).

[182] *Id.* at 538.

[183] *Id.* at 525.

[184] *Id.* at 531 (quoting Donaghue v. Stevenson, [1932] A.C. 562, 619 (H.L.)). *Donaghue*, a products liability case, was an important influence in the cases discussed in this section. In that case, a manufacturer of ginger-beer (not an inherently dangerous article) was held liable in negligence under Scots law (the same as English law on the issue) for the consequence of a decomposed snail in the product consumed by plaintiff. Atkin, L.J., spoke of "proximity" as "not confined to mere physical proximity, but . . . intended, to extend to such close and direct relations that the act complained of directly affects a person whom the [first] person . . . would know would be directly affected by his careless act." *Id.* at 581.

The frustration of the *Restatement* reporter and others over the "vagueness" of the opinions is understandable.[185] But unlike the reporter, who was searching for an expression that would support a clear-cut generality of broad scope and fairly well-defined bounds, such as the specifically foreseen person–limited class standard, the justices intentionally were looser in their formulations, and more inclined to be guided by qualitative considerations as derived from individual bodies of facts in discrete circumstances.

In *Dimond Mfg. Co. v. Hamilton*,[186] a 1969 case involving acquisition of the defendant-auditor's client, the New Zealand Court of Appeal, on facts closely resembling those in *Candler*, applied the special relationship language of *Hedley Byrne*. It held the requisite relationship had been created at the time when a partner of the defendant-audit firm, which had been negligent in auditing a client's financial statements, showed them to the plaintiff at the client's request for the purpose of plaintiff's making the offer by which he purchased all of the client's shares in reliance on the financial statements. The relationship was found to exist even though the audit had been completed several months earlier.[187]

Meanwhile, things were changing in England, where the House of Lords announced a willingness to depart from precedent in appropriate circumstances.[188] In 1970, in a property damage case, the law lords more or less abandoned the syllogism in negligence cases which had been cherished by common-law lawyers for centuries.

> The form of the order assumes the familiar analysis of the tort of negligence into its three component elements, viz the duty of care, the breach of that duty and the resulting damage. The analysis is logically correct and often convenient for purposes of exposition, but it is only an analysis and should not eliminate consideration of the tort of negligence as a whole. It may be artificial and unhelpful

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In support of the expansion of liability for negligence, another justice said: "The grounds of action may be as various and manifold as human errancy; and the conception of legal responsibility may develop in adaptation to altering social conditions and standards. The criterion of judgment must adjust and adapt itself to the changing circumstances of life." *Id.* at 619.

[185] *See supra* notes 35 & 175 and accompanying text.

[186] [1969] N.Z.L.R. 609 (N.Z. Ct. App.).

[187] *Id.* at 628.

[188] In 1966 the law lords affirmed their respect for the use of precedent as affording some degree of certainty and as a basis for orderly development of law, but said that "too rigid adherence to precedent may lead to injustice in a particular case and also unduly restrict the proper development of the law." Note, [1966] 3 All E.R. 77 (H.L.). Accordingly, while continuing to treat their precedents as normally binding, they would change their procedure and would depart from precedent "when it appears right to do so." *Id.*

> to consider the question as to the existence of a duty of care in isolation from the elements of breach of duty and damage. The actual damage alleged to have been suffered by the [plaintiffs] may be an example of a kind or range of potential damage which was foreseeable, and if the act or omission by which the damage was caused is identifiable, it may put one on the trail of a possible duty of care of which the act or omission would be a breach. In short, it may be illuminating to start with the damage and work back through the cause of it to the possible duty which may have been broken.[189]

A justice observed that on the facts "in the present case it would not only be fair and reasonable that a duty of care should exist but that it would be contrary to the fitness of things were it not so."[190] Another found *proximity*: "[A]s boat-owners [plaintiffs] were in law *'neighbours'* of the [defendants] and so there was a duty of care owing by the [defendants] to [them]. . . . To some extent the decision in this case must be a matter of impression and instinctive judgment as to what is fair and just."[191]

A definition of "neighbour" by a justice in an important earlier products liability case is evocative of the road to Jericho,[192] though "in law" its qualities are admittedly more "restricted" than those of the Good Samaritan:

> The rule that you are to love your neighbour becomes in law: You must not injure your neighbour, and the lawyers' question: Who is my neighbour? receives a restricted reply. You must take reasonable care to avoid acts or omissions which you can reasonably foresee would be likely to injure your neighbour. Who then, in law, is my neighbour? The answer seems to be persons who are so closely and directly affected by my act that I ought reasonably to have them in contemplation as being so affected when I am directing my mind to the acts or omissions which are called in question.[193]

In dictum in a 1977 damage suit for defective house construction, one of the justices illustrated his interpretation of *Hedley Byrne* with the following example:

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[189] Home Office v. Dorset Yacht Co., [1970] A.C. 1004, 1052 (H.L.). In *Dorset Yacht* inadequately supervised borstal (reform) school boys escaped and stole a yacht that collided with and damaged plaintiff's yacht. The Home Office was held liable for the negligence of its personnel in failing to adequately supervise the inmates. Judge Cardozo's opinion in Palsgraf v. Long Island R., 248 N.Y. 339, 162 N.E. 99 (1928), was cited. *Dorset Yacht*, [1970] A.C. at 1036.

[190] *Id.* at 1039.

[191] *Id.* at 1054 (emphasis added).

[192] *Luke* 10:27-37.

[193] Donoghue v. Stevenson, [1932] A.C. 562 (H.L.).

> [A] well known firm of accountants certifies in a prospectus the annual profits of the company issuing it and unfortunately, due to negligence on the part of the accountants, the profits are seriously overstated. Those persons who invested in the company in reliance on the accuracy of the accountants' certificate would have a claim for damages against the accountants for any money they might have lost as a result of the accountants' negligence.[194]

The *Hedley Byrne* of that dictum is no longer, if ever it really was, the *Hedley Byrne* that United States lawyers had been associating with specifically foreseen persons or even limited foreseen classes. The implication for accountants' liability to nonclients is evident.

Two of three justices in *Scott Group Ltd. v. McFarlane*,[195] a 1978 New Zealand appellate decision, reached the rather radical conclusion that the negligent defendant-auditor had a duty of care (under *Hedley Byrne*) to a subsequent purchaser of its publicly owned and traded corporate client whose reliance upon the auditors was reasonably foreseeable. The court arrived at this result on the basis that the client appeared vulnerable to takeover, though the proposed purchase and purchaser were unknown to the auditor at the time of audit and such reliance therefore was not and could not have been actually foreseen by him.[196] The justice who dissented on the law (citing *Hedley Byrne* and other authorities, and quoting section 552 and accompanying comments at some length) reasoned that a special relationship requires that the auditor be aware that some particular person or class will rely upon the auditor's opinion for the purpose of some particular type of transaction.[197] Accountants, the dissent concluded, should not be treated

> as assuming a responsibility towards all persons dealing with the company or its members, in reliance to some greater or lesser degree on the accuracy of the accounts, merely because it was *reasonably foreseeable*, in a general way, that a transaction of the kind in which the plaintiff happened to become involved might indeed take place.[198]

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[194] Anns v. London Borough of Merton, [1978] A.C. 728 (H.L.).

[195] [1978] 1 N.Z.L.R. 553, 580 (N.Z. Ct. App. 1977) ("an elementary error" of failing to eliminate double-counting of subsidiary income to the extent that it was received by the parent in dividends), *cited in Rosenblum*, 93 N.J. at 350 n.13, 461 A.2d at 153 n.13; see *supra* notes 160-63 and accompanying text for a discussion of *Scott Group*.

[196] *Scott Group*, [1978] N.Z.L.R. at 580.

[197] *Id.* at 560-68 (citing and quoting § 552 and comments; citing *Ultramares*, 255 N.Y. at 170, 174 N.E. at 441, *Glanzer*, 233 N.Y. at 236, 135 N.E. at 275, and W. PROSSER, HANDBOOK OF THE LAW OF TORTS 706-09 (4th ed. 1971)).

[198] *Id.* at 566 (emphasis added).

One of the two justices in the majority said of *Hedley Byrne* that "a duty of care owed by the authors of negligent information or advice to those who rely upon it . . . depends upon the existence of the *rather elusive sort of relationship* discussed in that case."[199] In order to "remove some degree of uncertainty," he subscribed to the "comprehensible and straightforward test of foreseeability."[200] As to limitations on such a standard of duty, he considered it "unwise to endeavour to lay down in advance precise rules," because "[t]he facts of individual cases are likely to provide a far more reliable and equitable guide."[201] On the facts of the case at hand, he considered the defendant-auditor to be culpable under the foreseeability rule, and found no reason to limit the force of the rule.[202]

The other justice in the majority on the law found that the takeover transaction was "reasonably foreseeable,"[203] but he used the term in a factual sense, not as a generality. He then observed that "[t]he authorities are replete with warnings against generalizing in the law of negligence,"[204] quoting a House of Lords opinion which stated:

> "As with any other important case in the development of the common law *Hedley Byrne* should not be regarded as intended to lay down the metes and bounds of the new field of negligence of which the gate is now opened. Those will fall to be ascertained step by step as the facts of particular cases which come before the courts make it necessary to determine them."[205]

He spoke of the "signposts . . . involving such notions as *neighbours*, control, *proximity*. . . . [W]hatever the general formulations current from time to time, an essentially pragmatic approach has been characteristic of the leading English tort cases in modern times. . . ."[206] His citation of section 552 amounted to damnation with faint praise:

> Instructive as is the Second Restatement of the Law of Torts adopted and promulgated by the American Law Institute in 1976 and published in 1977, it must face the usual difficulties besetting any attempt at crystallisation [sic] in the nature of a code in a wide

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[199] *Id.* at 572 (emphasis added).
[200] *Id.* at 574.
[201] *Id.* at 575.
[202] *Id.* at 575-76.
[203] *Id.* at 582.
[204] *Id.*
[205] *Id.* at 582-83 (quoting Mutual Life & Citizen's Assurance Co. v. Evatt, [1971] A.C. 793).
[206] *Id.* at 584 (emphasis added).

> and constantly developing field. For instance, not surprisingly the whole of sec [sic] 552 contains no example of a case exactly fitting the present.[207]

After the considerable amount of time devoted to the negligence issue, one of the two justices in the majority on the law concluded that plaintiff had failed to prove damages. This resulted in a different and disparate majority awarding victory to the auditor.

The opinion in the more recent *JEB Fasteners Ltd. v. Marks, Bloom & Co.*[208] is cited conspicuously in *Rosenblum*,[209] and may have influenced its outcome. As in *Scott*, the *JEB* controversy arose from a takeover of the defendant-auditor's client, in which the negotiations commenced after the completion of the audit. Upon request, the auditor prepared and furnished to plaintiff's principals various information concerning the client.[210] It was subsequently determined that the audited financial statements for the year preceding the takeover by plaintiff reflected an assortment of negligent errors, although the only significant error was a material overstatement of inventory valuation, without which there would have been a net loss rather than a net income.[211]

The opinion is useful because it opens with a brief though concentrated survey on the United Kingdom and Commonwealth law of accountants' liability to nonclients for negligence.[212] The court found that since the auditor was aware during the audit that the client needed outside financial support, it ought reasonably to have foreseen (i.e., perceived that there was a reasonable foreseeability) that a takeover by an acquirer relying on the audited financial statements would occur.[213] Upon analysis of the precedents, and "[w]ithout laying down any principle which is intended to be of general application,"[214] the court concluded that the auditor's knowledge established a duty of care to plaintiff.[215]

The court, however, also concluded from the evidence that plaintiff's management, which was experienced in the same line of business, suspected that the inventory was substantially overvalued, and

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[207] *Id.*

[208] [1981] 3 All E.R. 289, *aff'd*, [1983] 1 All E.R. 583 (C.A.) (citing *Ultramares*, 255 N.Y. at 170, 174 N.E. at 441, § 552, and Rhode Island Hosp. Trust Nat'l Bank v. Swartz, Bresenoff, Yavner & Jacobs, 455 F.2d 847 (4th Cir. 1972)).

[209] *Rosenblum*, 93 N.J. at 333 & 352 n.14, 461 A.2d at 142 & 153 n.14.

[210] *JEB*, [1981] 3 All E.R. at 299.

[211] *Id.* at 300.

[212] *Id.* at 291-96.

[213] *Id.* at 300-01.

[214] *Id.* at 296.

[215] *Id.* at 301.

that they were interested primarily in obtaining the services of the client's two principal officers, who actually proved to be a great disappointment. On that evidence, the court ruled that the defendant-auditor's negligence was not the cause of plaintiff's loss, and entered judgment for defendant.[216]

Since it appears that the recent United Kingdom-Commonwealth opinions may be tending to influence the United States law of negligent misrepresentation away from the specifically foreseen toward the reasonably foreseeable, or may do so in the future, it becomes important for United States judges and lawyers to be aware of the rationale of those opinions. The need for such awareness becomes particularly apparent when it is realized that the liberality of those opinions may result in greater monetary risks in United States litigation because of the following considerations: the availability of class action suits; recovery of contingent plaintiffs' counsel fees; more liberal damages formulations; and heavier defense litigation expenses with no prospect, as there is in the United Kingdom-Commonwealth, of reimbursement from plaintiff in the event of a successful defense. Thus, one may respect the generally excellent quality of the United Kingdom-Commonwealth opinions without necessarily accepting the intellectual processes employed in their formulation.

Opinions in which the major premise of the syllogism—the general rule of law—has been diluted to a point of insignificance may appeal to some jurists, not only as a convenient means of administration of litigation, but more importantly because the judges believe sincerely, and perhaps with some justification, that they may thereby achieve more equitable results. In the view of many jurists and lawyers, however, those advantages are considered to be outweighed by the resulting tendency to obscure the substantive rules that everyone is expected to observe in his relations with other persons, and that are helpful to legal advisers in guiding their clients in observance of the law. Even with the imperfection attendant on all human effort, the *Restatements of the Law* are one monument to the preponderant belief of the bar in the United States that observance of the law is fostered by clarity in the enunciation of legal rules.[217]

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[216] *Id.* at 301, 304-05. Similarly, Toromont Indus. Holdings Ltd. v. Thorne, Gunn, Helliwell & Christenson, 62 D.L.R.3d 225, 247, 252 (Ont. High Ct. 1975) (defendant-auditor's damages limited to cost of new audit and any related legal expenses), *modified,* 73 D.L.R.3d 122, 124 (Ont. Ct. App. 1976), *cited in Rosenblum,* 93 N.J. at 350 n.12, 461 A.2d at 122 n.12.

[217] Occasionally, there are attempts to deviate from that approach. For instance, the persistent advocacy by one United States court of appeals of a "flexible duty standard," originally of

V. THE CONSEQUENCES

In the United Kingdom and Commonwealth and in New Jersey and Wisconsin, the liability of accountants to nonclients for negligence is determinable by reasonable foreseeability.[218] In a different minority of United States jurisdictions, their liability continues to be limited largely to those with whom they are in privity of contract,[219] although the vitality of that limitation has diminished over the years. In a considerable number of jurisdictions, their liability is measured by the intermediate *Restatement* test of the specifically foreseen person and limited class.[220] That view appears to predominate at the present time. The recent adoption of the reasonable foreseeability test by two state's highest courts does not necessarily foretell a trend away from the foreseen, but may provide only another illustration of local divergencies in a multistate system of law.

Despite the fact that an accountant who is negligent is less culpable than one who commits fraud, the application of reasonable foreseeability to negligence would expose an accountant who is only negligent to consequences as severe as those which visit an accountant who commits fraud.[221] The objective of influencing the behavior of defendants is forgotten when courts become preoccupied with compensating plaintiffs.

Some courts, including the New Jersey Supreme Court in *Rosenblum*, have revealed a disconcertingly casual attitude concerning accountants' liability insurance, assuming that through insurance, accountants may serve as a conduit for spreading losses to the public

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negligence, in cases under § 10(b) of the Securities Exchange Act and SEC rule 10b-5, 15 U.S.C. § 78j (1982) and 17 C.F.R. § 240.10b-5 (1983), respectively, varying qualitatively according to defendant's relationship to plaintiff, access to information, benefit, and actions, in a succession of opinions starting with White v. Abrams, 495 F.2d 724, 735-36 (9th Cir. 1974). See Spectrum Fin. Cos. v. Marconsult, Inc., 608 F.2d 377, 380 (9th Cir. 1979) (reversing summary judgment for co-defendant auditors), *cert. denied*, 446 U.S. 936 (1980), including a specially concurring opinion asserting that subsequent to Hochfelder v. Ernst & Ernst, 503 F.2d 1100 (7th Cir. 1974), *rev'd on other grounds*, 425 U.S. 185 (1976) (which rejected a negligence standard of duty under rule 10b-5) it is inappropriate "to engage in a complex, multi-facted [sic] duty analysis which was designed to test negligence." *Spectrum Fin. Cos.*, at 384. The flexible duty standard has not been accepted widely by courts other than federal district courts in the circuit of its origin.

[218] See also *supra* note 115 for a discussion of one California court's obvious preference for the reasonable foreseeability standard.

[219] *See, e.g.*, authorities cited *supra* note 42.

[220] *See, e.g.*, *Rusch*, 284 F. Supp. at 85; *Ryan*, 170 N.W.2d at 395; *see also* authorities cited *supra* note 78.

[221] *See* RESTATEMENT (SECOND) OF TORTS §§ 531, 550-51 (1977).

in the form of higher fees for professional services.[222] Perhaps judges become case-hardened in observing accountants, as well as other professionals, represented in litigation by insurance defense counsel. The language in the opinions suggests that the judges may view such insurance as a commodity readily purchasable in a variety of shapes, sizes, and most-wanted features.

The brief statements in most of the opinions cite no factual bases for the courts' observations, and some suggest that the courts in fact had none.[223] In *Rosenblum*, for instance, neither the plaintiffs nor the defendant briefed or argued the subject of insurance before the New Jersey Supreme Court, except in answers to some questions asked by the court.[224] Nevertheless, the court stated: "Independent auditors have apparently been able to obtain liability insurance covering these risks or otherwise to satisfy their financial obligations. We have *no reason to believe* that they may not purchase malpractice insurance policies . . ." covering negligence.[225] In support of that statement, the court cited 1976 and 1969 information on insurance companies issuing such policies with a low maximum coverage,[226] but furnished no information as to those companies' criteria in underwriting individual risks. Only when the defendant contended in oral argument that the cost of coverage against foreseeability risk would be "catastrophic" did the court invoke the legal formalities, saying that "defendants have not alerted us to data either within or outside the record to support this position."[227] The intermediate appeals court at least acknowledged defendants' argument that the aggregate claims of $100 million

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[222] *Rusch*, 284 F. Supp. at 91; Spherex, Inc. v. Alexander Grant & Co., 122 N.H. 898, 904, 451 A.2d 1308, 1312 (1982); *Citizens State Bank*, 113 Wis. 2d at 384, 335 N.W.2d at 365; *Scott Group*, [1978] 1 N.Z.L.R. at 572. None of these opinions cited any evidence of other supporting factual authority; *Spherex* referred to a law review student note. *Spherex, Inc.*, 122 N.H. at 904, 451 A.2d at 1312 (citing Note, *Accountants' Liability for Negligence—A Contemporary Approach for a Modern Profession*, 48 FORDHAM L. REV. 401 (1979)). For contrary views, recognizing the potential problems associated with accountants' liability insurance, see Briggs v. Sterner, 529 F. Supp. 1155, 1177 (S.D. Iowa 1981) (costs of liability insurance exceed benefits derived from spreading risk to public at large); H. Rosenblum, Inc. v. Adler, 138 N.J. Super. 417, 422, 444 A.2d 66, 68 (App. Div. 1982) (making reference to defendant-auditor's contention that accountants could not endure costs of liability insurance), *aff'd in part, rev'd in part*, 93 N.J. 324, 461 A.2d 138 (1983).

[223] *See supra* note 222.

[224] *Rosenblum*, 93 N.J. at 349 & n.11, 461 A.2d at 151 & n.11.

[225] *Id.* (emphasis added).

[226] *Id.* at 349 n.11, 461 A.2d at 151 n.11 (citing Note, *Accountants' Liability for Negligence—A Contemporary Approach for a Modern Profession*, 48 FORDHAM L. REV. 401, 415 n.81 (1979)).

[227] *Id.* at 349 n.11, 461 A.2d at 151 n.11.

in related litigations were effectively uninsurable, at least on tolerable terms.[228]

One suspects that other courts are also guided only by conjecture concerning the availability to practicing accountants of liability insurance. Such conjecture is unwarranted in the absence of evidence in the litigation record, especially in the case of smaller firms and practitioners. Insurers enter into and withdraw from particular lines of insurance in accordance with what they perceive to be their best business interests, developing a new line to seek profits, and discontinuing an existing line to stem losses. For a time during recent years, only one insurer was offering accountants' liability insurance in New York, with a maximum coverage of only $2 million, a sum inadequate for practitioners other than those serving clients of modest means and activities. During that period, premium charges increased radically. In addition, insurers have become increasingly discriminating in the issuance and renewal of coverage. During periods when insurers have had unfavorable loss and loss expense experience, there have been increased numbers of instances in which accountants have experienced denials of coverage by their insurers on arguably questionable grounds, and pressure from their insurers to contribute to the settlements of claims. Moreover, insurance does not compensate an accountant for the sometimes extensive amount of time diverted from his practice to the litigation, and for the loss of productivity as a result of distraction. The courts' statements suggest a lack of acquaintance with accountants' liability insurance problems.

Since much or all of the cost of liability insurance may be passed on to accountants' clients and ultimately to the public,[229] the utility of imposing such a cost is debatable.[230] It would be most informative if comparative data could be obtained of the amounts of payments under those policies for (1) losses, including settlements, and (2) loss expenses, which are largely litigation costs.

Apart from the subject of insurance, courts and commentators do not witness the continuing destructive effect of adjudication of professional liability upon the professional practice and stature of accountants,[231] the human blight that extends beyond their professional ca-

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[228] H. Rosenblum, Inc. v. Adler, 183 N.J. Super. 417, 422, 444 A.2d 66, 68 (App. Div. 1982), *aff'd in part, rev'd in part,* 93 N.J. 324, 461 A.2d 138 (1983).

[229] *Rosenblum,* 93 N.J. at 350, 461 A.2d at 152; Briggs v. Sterner, 529 F. Supp. 1155, 1177 (S.D. Iowa 1981); *Rusch,* 284 F. Supp. at 91.

[230] Briggs v. Sterner, 529 F. Supp. 1155, 1177 (S.D. Iowa 1981).

[231] *Haddon View,* 70 Ohio St. 2d at 160-61, 436 N.E.2d at 216-17 (Krupansky, J., dissenting).

reers into their personal lives, and the stress that impairs their productivity and their physical and emotional health.[232] It is true in general that practitioners of professions and callings are exposed to varying risks, according to the nature of their services and those affected by them, but a distinctive characteristic of risk in the practice of professional accounting and auditing is that an error—innocent, negligent, reckless, or worse—may lead to claims by large numbers of people of potentially enormous aggregate losses.[233] A minor error committed in a brief lapse from the exercise of reasonable care may have severe financial consequences, and may entail risk of financial responsibility on a scale that is grotesquely disproportionate to the culpability of the professional.[234]

Those who are familiar with accounting and auditing processes are aware of the limitations and human imperfections of the processes and the information. Not all the things that should be detected will be detected. Not all the things that are observed by the professional are what they seem to be. Although in hindsight, accountants and auditors, as well as judges and juries, can *observe* what was not observed before, there will always be disagreement over what was then *observable* in the exercise of care. Because of the magnitude of potential loss, professional accounting is a high-risk activity. Despite the chorus of commentators who consider their wisdom to be superior to Judge Cardozo's, in his risk evaluation, Cardozo had it right the first time.

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[232] *See* Goldwasser, Accountants' Professional Liability—Study Guide 3-2, 3-3 (1982).

[233] One exception are those special engagements of such nature that the accountant's work will be relied upon by only one or, at most, few nonclients. *E.g.*, United States Nat'l Bank v. Fought, 291 Or. 201, 630 P.2d 337 (1981) (defendant-accountant's reports of accounts receivable collections for reliance of client's sole bank lender in making additional advances).

[234] As Prosser has written, "The spectre of unlimited liability, with claims devastating in number and amount crushing the defendant because of a momentary lapse from proper care, has haunted the courts." W. PROSSER, HANDBOOK OF THE LAW OF TORTS 708 (4th ed. 1971), *quoted in* Denbeste v. Meriwether, Wilson & Strick, No. 75-35-D, slip op. at 4 (S.D. Iowa Sept. 2, 1981) (defendant-auditor).