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IN THE SUPREME COURT OF FLORIDA

CASE NO. 74,034

FIRST FLORIDA BANK, N.A.,
f/k/a FIRST NATIONAL BANK
OF FLORIDA,

Petitioner,

vs.

MAX MITCHELL & CO., P.A.,
and MAX W. MITCHELL,

Respondents.

AMICUS CURIAE BRIEF OF
FLORIDA INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS
IN SUPPORT OF RESPONDENTS' POSITION

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TABLE OF CONTENTS

PAGE

TABLE OF CONTENTS - continued PAGE

TABLE OF AUTHOR1TIES

PAGE

Cases:

INTRODUCTION

The Florida Institute of Certified Public Accountants ("FICPA") is a Florida not-for-profit corporation with its principal place of business in Tallahassee, Florida. Founded in 1905, the FICPA is an active professional organization of approximately 17,000 Certified Public Accountants (CPAs) working to improve the accounting profession and to better serve the public. The FICPA is the fifth largest state CPA organization in the United States. Its membership is comprised of practitioners in public accounting, industry, government and education. Other membership categories include associate members, retired CPAs and CPAs domiciled outside the State of Florida.

One of the primary purposes of the FICPA is to encourage the analysis, discussion, and understanding of the issues and trends in the accounting profession. This includes monitoring the status of CPA's liability throughout the United States, assisting in the development of auditing and accounting standards, analyzing the market availability and cost of professional liability insurance, and educating the public with regard to the activities of CPAs in carrying out their duties. The FICPA also has a disciplinary program by which it disciplines its members who fail to meet the technical standards of the profession. All these areas of activity directly relate to the issues now before this Court.

The following symbols will be used in this Brief:

"R"	=	Record
"Bank"	=	First Florida Bank, N.A. f/k/a First National Bank of Florida, Petitioner, Appellant below, Plaintiff below
"C.M. Systems"	=	C.M. Systems, Inc.
"Mitchell" or "Max Mitchell"	=	Mitchell or Max Mitchell, Respondent, Appellee below, Defendant below
"Max Mitchell & Company, P.A."	=	Max Mitchell & Company, P.A., Respondent, Appellee below, Defendant below
"Hickman"	=	Steven Hickman, Vice President of First Florida Bank, N.A.
"FICPA"	=	The Florida Institute of Certified Public Accountants, Amicus Curiae in support of the Respondents
"Investors"	=	The unidentified investors who have intervened in this action as Amici Curiae in support of the Petitioner and who are investors in a company unrelated to these proceedings

SUMMARY OF ARGUMENT

Florida law provides that an accountant who commits accounting malpractice is liable to his client for the results Of his actions. Absent fraud, an accountant may not be held liable to third parties unless the accountant is in privity with such third parties. This is often referred to in malpractice actions by third parties as a privity requirement.

Based on developments of law in areas unrelated to accounting, Petitioner and Investors are asking this court to abolish a long-standing rule of law in this state and to permit a lender not in privity with its borrower's accountant to bring suit against that accountant for negligence. If this Court were to grant this request, it would have a wide ranging effect not only upon the Respondents in this case, but on each of the 17,000 members of the FICPA -- a substantial number of whom work as sole practitioners or in small firms.

At the heart of this case lies a fundamental question of public policy concerning the extent of an accountant's liability in Florida. A proper analysis of this public policy issue requires an understanding of the auditing process and the nature of modern business enterprise. There are valid distinctions between professional suppliers of information such as accountants and suppliers of products of tangible property and other services.

The intangible nature of financial information makes its dissemination impossible to control. If held liable for negligence to third parties, accountants would be exposed to staggering financial liability based on the extent to which the financial statements are circulated by others. The public policy considerations which are relevant to these issues call for retention, not abandonment of Florida's privity requirement. This is particularly true in view of the unstable liability insurance market in Florida.

ARGUMENT

POINT I

THE COURT SHOULD ANSWER THE CERTIFIED QUESTION OF THE DISTRICT COURT OF APPEAL, SECOND DISTRICT, ONLY WITH REGARD TO THE FACTS OF THE CASE NOW BEFORE IT.

The issue now before this Court is a complex question which involves a long-standing rule of law. The sixty-six page record in this case is not adequate to support the fundamental changes in Florida law suggested by Investors. If changes to Florida's privity requirement in actions involving accountants are to be considered by this Court, they should be considered only in the context of a case and record which addresses the issues being argued.[1]

The District Court of Appeal, Second District, has certified the following question as one of great public importance:

> Where an accountant fails to exercise reasonable and ordinary care in preparing the financial statements of his client and where that accountant personally delivers and presents the statements to a third party to induce that third party to loan to or invest in the client, knowing that the statements will be relied upon by the third party in loaning to or investing in the client, is the accountant liable to the third party in negligence for the damages the third party suffers as a result of

[1] See Point VI and accompanying text for an analysis of why many of the policy issues discussed in this Brief should be addressed by the Legislature rather than this Court.

> the accountant's failure to use reasonable and ordinary care in preparing the financial statements, despite a lack of privity between the accountant and the third party?

First Florida Bank, N.A. v. Max Mitchell & Co., P.A., 541 So.2d 155, 157 (Fla. 2d DCA 1989)

In certifying this question, the Second District has asked this Court to decide whether an accountant, in certain limited situations, is liable in nealiaence to a third party when there is no privity between the parties. As acknowledged by the District Court of Appeal, the answer to the certified question, under existing Florida law, is clearly "no."

In their Briefs, Petitioner and Investors have phrased their arguments in ways that alter the certified question. Although acknowledging the certified question, the Petitioner has altered the phrasing of its argument to characterize itself as an intended beneficiary. The term "intended beneficiary" is used to refer to a third party that meets certain criteria at the time the primary parties enter into a contract. See Marianna Lime Products Co. v. McKay, 109 Fla. 275, 147 So. 264 (1933) (the contract must show that it was the parties' intent to benefit a third party). This qualification is not in the certified question and the facts to support such a finding are not in the record.

The Petitioner has also characterized the Respondent as the negotiator of the loan. This characterization involves actions taken by Respondent subsequent to performing the audit.

Furthermore, Respondent's activities are not typical of accountants and are unrelated to an accountant's responsibility. If, subsequent to performing the audit, Respondent performed acts other than accounting services, these actions should not be treated as accounting malpractice. If false statements were made to a bank to secure a loan, liability may exist, but it is unrelated to the performance of the original audit **services.**[2] This case appears to be very unique, and this Court should not promulgate a principle of law of general applicability in order to address an unusual situation.

Although Investors conclude their Brief by referring to the certified question, the majority of their Brief involves the analysis and application of legal theories regarding privity which are unrelated to the issues and facts of this case. However, a review of the "facts" and argument set forth in Investors' Brief makes clear their interest in seeking a fundamental change in the law of Florida. Investors frame the issue in terms far broader than the issues contained in the certified question in an attempt to have this Court provide an answer to the certified question that would apply to Investors' pending case. Without Investors' record, this Court should avoid such a result.

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[2] See *infra*, page 34, regarding the requirement that a third party beneficiary be known at the time of the audit.

POINT II

FLORIDA LAW REQUIRES PRIVITY BEFORE A PARTY CAN BRING AN ACTION AGAINST AN ACCOUNTANT FOR ACCOUNTING MAL-PRACTICE.

A. As Recently Affirmed By The District Courts Of This State, Privity Is Required Before A Plaintiff May Bring An Action Against An Accountant For A Failure to Perform Services.

Florida courts have long recognized the soundness of allowing only those parties who are in privity of contract with an accountant to bring an accounting malpractice action. Despite attempts to abolish the privity requirement, Florida courts have repeatedly upheld this prudent doctrine. Gordon v. Etue. Wardlaw & Co., 511 So.2d 384 (Fla. 1st DCA 1987); Investors Tax Sheltered Real Estate, Ltd. v. Laventhol, Krekstein. Horwath & Horwath, 370 So.2d 815 (Fla. 3d DCA 1979), cert. denied, 381 So.2d 767 (Fla. 1980); Canaveral Caaital Corp. v. Bruce, 214 So.2d 505 (Fla. 3d DCA 1968); and Investment Corp. of Florida v. Buchman, 208 So.2d 291 (Fla. 2d DCA), cert. dismissed, 216 So.2d 748 (Fla. 1968). The only exception has been parties who were subrogated to the rights of an accountant's client. See Dantzler Lumber & Export Co. v. Columbia Casualty Co., 115 Fla. 541, 156 So. 116 (Fla. 1934).

The Petitioner and Investors rely on First American Title Insurance Co. v. The First Title Service Co. of the Florida Keys, Inc., 457 So.2d 467 (Fla. 1984), for the proposition that this Court has modified the basis upon which Florida's privity requirement for accountants has been based.

This position is based on a misreading of First American and a misunderstanding of Florida's privity requirement.

In First American, a title insurer brought an action against an abstractor that prepared an abstract for a seller of certain property. The title insurance company alleged that it relied on the abstracts in issuing a title insurance policy and that the abstractor knew that it would rely on such abstracts. **This Court held that the title insurer stated a cause of action** as a third-party beneficiary of the abstractor's contract of employment with the seller.

It is important to emphasize that the potential liability found in First American was based on contract principles. In First American this Court stated:

> Although we decline to recognize an abstractor's liability in tort for negligence to any and all foreseeable injured parties, we hold that the plaintiff here stated a cause of action as a third party beneficiary of the contract of employment of the abstractor. (Emphasis added.)

Id. at 418. Privity is a contract principle, not a negligence principle, and contract law has long recognized that parties may contract to create rights in a third-party beneficiary. This concept, however, requires the accountant to agree to the creation of such rights as part of his contract with his client.

The certified question asks if there is liability in negligence and is based on a finding that there was no privity between the Petitioner and Respondents. Therefore, the

District Court's question must be answered in the negative. There are no alleged facts, and certainly no evidence in this record, that would support a finding that the Petitioner was an intended third party beneficiary of the contract for auditing services between Max Mitchell and C. M. Systems.

Furthermore, this Court should not be persuaded to extend the liability of accountants based on an analogy between abstractors and accountants. The nature of the job undertaken by an abstractor is very different from the engagement undertaken by an accountant in performing an audit. An abstractor is hired to determine what is in the <u>public</u> record. He need only ascertain and record all <u>recorded instruments</u> affecting title to property. The abstractor exercises little or no discretion in his work. An accountant, however, must review a sample of data provided by private individuals and render an <u>opinion</u> as to the validity of the information. The accountant must make judgment calls at virtually every step of his engagement. The data (deeds, judgments, lis pendens) upon which an abstractor relies have been prepared and recorded with accuracy and precision. On the other hand, the data upon which accountants must rely are often the result of business judgments.

In addition, the number of potential claimants is very different in instances involving abstractors and those involving accountants. A real estate transaction by its very nature involves a fixed and limited number of participants. A company's financial statements, however, may be utilized by hundreds, even thousands, of creditors or investors over an extended period of time.

These distinctions are important because they have been the historical basis for limiting accountants' liability to third parties. As shown below, courts have consistently recognized the unique responsibilities and burdens accountants face in performing audit services.

B. The Historical Basis Of Florida's Limitation On the Liability Of Accountants To Third Parties.

Privity of contract is the relationship which exists between two or more contracting parties, and was traditionally required to maintain an action on any contract. The theory derives from the early English contract law which limited the enforcement of contracts to those made between mutually consenting parties. Winterbottom v. Wright, 10 M.& W. 109, 152 Eng. Rep. 402 (Ex. 1842). Although Winterbottom was an action in contract, English courts later applied the principle to tort actions in negligence as well. E.g., Lelievre v. Gould, [1893] 1 Q.B. 491, 497 (C.A.) (involving a surveyor's liability to third parties in connection with his certification).

An accountant who agrees with a client to perform services is said to be in privity with his client because they have a contractual relationship. The issue now before this Court is whether an accountant has liability in negligence to third parties who are not his clients and with whom he is not in privity.

The question of the proper scope of liability in actions against accountants is the subject of one of the most often cited opinions in American jurisprudence, Ultramares Corp. v. Touche, 255 N.Y. 170, 174 N.E. 441 (1931). The public accountants in Ultramares had negligently reported erroneous financial statements. They knew that their client had required extensive credit and had borrowed large sums of money from various lenders, and knew also that "... in the usual course of business the balance sheet when certified would be exhibited by the [audit client] to banks, creditors, stockholders, purchasers, or sellers, according to the needs of the occasion, as the basis of financial dealings." 174 N.E. at 442. Suit was filed by a creditor who had loaned substantial sums to the company in reliance upon the audited statements, but who was not specifically known to the defendants. The court considered at length the question of whether the accountant owed a duty of care to a plaintiff with whom there was no contractual client relationship. In denying recovery to the plaintiff-creditor, Judge Cardozo reasoned that to hold otherwise would expose the accounting profession to potential liability grossly disproportionate to the degree of 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.

174 N.E. at 444.

The decision to limit accountants' liability is particularly significant when viewed in the light of two decisions that preceded Ultramares and which were also authored by Judge Cardozo. In MacPherson v. Buick Motor Co., 217 N.Y. 382, 111 N.E. 1050 (1916), Cardozo's opinion substantially expanded the tort liability of manufacturers of defective products. MacPherson virtually eliminated privity as a relevant consideration in products liability actions, holding manufacturers to a duty of care that extended to all those who reasonably and foreseeably might be injured by their products. 111 N.E. at 1053.

In Glanzer v. Shepard, 233 N.Y. 236, 135 N.E. 275 (1922), Judge Cardozo went beyond traditional requirements of privity and concluded that suppliers of information could in certain circumstances be held liable to a party who was not the suppliers' client. The defendants in Glanzer were public weighers who certified the weight of a quantity of beans in order to establish a purchase price. The purchaser of the beans later discovered that the weight had been overstated. The purchaser sued to recover the excess in price from the defendant-weighers because of the latter's negligence. The court held defendants liable, noting that the plaintiff's reliance on the weight certification was not "an indirect or collateral consequence of the action of the weighers," but a "consequence which, to the weighers' knowledge, was the end and aim of the transaction." 135 N.E. at 275.

Subsequently, when Ultramares came before the court, Judge Cardozo had no difficulty in distinguishing between the single specifically foreseen user of the bean weigher's report in Glanzer and the "indeterminate class" of foreseeable third parties who rely upon audited financial statements. While supplying information to the nonclient bean purchaser was the entire "end and aim" of the commercial transaction in Glanzer, the accountants in Ultramares delivered the audit report to their client for use "in the operation of its business as occasion might require." The service provided by the accountant was thus "... 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." Ultramares, 174 N.E. at 446. Judge Cardozo used the "privity or near-privity" formulation in Ultramares not as a mechanical application of archaic contract principles, but as shorthand for a fundamental policy decision that an accountant's duty is to his clients.

In State Street Trust Co. V. Ernst, 278 N.Y. 104, 15 N.E.2d 416 (1938), the New York Court of Appeals considered the privity in the context of a case where the accountants knew at the time of their audit that creditors would rely on their statements. Nevertheless, the New York Court reached the same result it had reached in Ultramares and the accountants were found to have no liability to third parties with whom they were not in privity.[3]

The issue of privity in accounting malpractice appears to have been directly considered by a Florida appellate court for the first time in Investment Corp. of Florida v. Buchman, 208 So.2d 291 (Fla. 2d DCA), cert. dismissed, 216 So.2d 748 (Fla. 1968). Based on Florida law and citing Ultramares and State Street, Buchman reached the same result as the New York courts. However, as early as 1934, this Court in Dantzler Lumber & Export Co. referred to the requirement for privity in accounting malpractice cases. In Dantzler, this Court allowed a third party to sue an accountant only because the third party acquired privity through a right of subrogation to the rights of the accountant's client. Thus, Florida has required privity in accounting malpractice actions at least since 1934 and, absent compelling public policy reasons, this requirement should not be discarded or eroded.

[3] New York continues to adhere to the principles of Ultramares. The focus in recent New York cases has been on the facts necessary to create privity with third parties. See Credit Alliance Corp. v. Arthur Andersen & Co., 493 N.Y.S.2d 435, 483 N.E.2d 110 (N.Y. 1985); and William Iselin & Co., Inc. v. Mann Judd Landau, 527 N.Y.S.2d 176, 522 N.E.2d 21 (N.Y. 1988).

POINT III

AN ANALYSIS OF PUBLIC POLICY AND PRAGMATIC CONSIDERATIONS DEMONSTRATES THAT FLORIDA'S PRIVITY REQUIREMENT SHOULD NOT BE DISCARDED OR ERODED.

A. The Nature Of The Auditing Process And Modern Business Enterprises Makes Imposition Of A Negligence Standard Inappropriate In Connection With Accountants Liability To Third Parties.

The reasoning behind a privity requirement is particularly sound in accounting malpractice actions. The potential liability to accountants is staggering and grossly disproportionate to the task an accountant undertakes in auditing financial statements. Ultramares at 444.

In performing an audit, an accountant scrutinizes the financial statements prepared by a business and expresses an opinion as to whether the company's financial position and results of operations are fairly presented in accordance with generally accepted accounting principles and standards. The audit procedure involves three general stages: (1) the investigation and collection of data, (2) the drawing of inferences from the findings, and (3) the presentation of conclusions. At each step, the auditor's task involves a high degree of professional judgment and discretion.

In fact, the nature of auditing judgments makes imposition of a negligence standard inappropriate in circumstances where there is potential liability to large numbers of third parties. The audit process is filled with professional judgments which make it inappropriate and inequitable to expose accountants to third party negligence actions. If such liability were imposed, the likely result would be creditor-versus-auditor litigation virtually every time a business defaults on its loans. Counsel for a disappointed creditor will invariably fashion an argument that one or another of an auditor's difficult judgment calls can be labeled as "negligent." Under a negligence standard, it would be all-too-tempting for a lay jury, with the aid of hindsight, to blame the auditor for not uncovering each and every company weakness that contributed to its default.

In order to demonstrate the complexity and judgmental nature of the audit process, an outline of one part of a simple audit is set forth below. An analysis of the audit process is detailed and time-consuming but it is necessary in order to evaluate the impact of the positions advocated by the Petitioner and Investors.

1. The Audit Process[4]

The nature of the audit process can be demonstrated by examining the sensitive judgment calls involved in the procedures an auditor utilizes to test his client's valuation of inventory. The auditor, before dealing with pricing of the inventory, must satisfy himself that the thousands of inventory items typically listed on management's schedules do exist (and

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[4]This example of the Audit Process and the Modern Business Enterprise on pages 17-24 were contained in briefs filed by Solinger, Grosz & Goldwasser, P.C., in Credit Alliance Corp. v. Arthur Andersen & Co., 493 N.Y.S.2d 435, 483 N.E.2d 110 (N.Y.1985).

are, in fact, owned by the client company). In practice, this means that the auditor must (i) implement sampling techniques enabling him, by a series of spot checks, to make reasonable assumptions regarding the validity of the entire inventory count; and (ii) test the company's internal accounting controls from which the auditor will be able to make further reasonable assumptions regarding the accuracy of the company's inventory records.

As a practical matter, it is only on the basis of small samples that an auditor can observe his client's adherence to proper inventory procedures and even reperform some of his client's actual physical counts. Accordingly, no matter how well-designed and well-executed the audit may be, the auditor cannot provide any guarantee, but merely some limited level of assurance, regarding the accuracy (within a material margin of error) of the company's inventory.

In counting inventory quantities, auditing complications abound. Usually, for example, a company's physical inventory cannot be taken precisely on the balance sheet closing date; indeed, in sizable companies, it is often taken in stages over the course of many weeks or months prior to that date. Judgments must then be made, in reliance on the company's internal controls, to adjust the figures so that they speak as of the closing date. Even more troublesome is the fact that inventory items are typically in motion during the inventory process -- that is, some are being moved from one company location to another (often as part of the manufacturing process) and some are moving in or out of the company premises (typically through the continuing purchase of raw materials and sale of finished products). To avoid either double-counting or overlooking of such inventory-in-motion, the auditor must again place reliance on company controls and make countless, difficult professional judgments.[5]

The counting process, however, is not nearly so complex as the auditor's next task -- the pricing process. Not only must the auditor seek to determine inventory costs based upon the company's method of accounting for inventory (e.g., LIFO or FIFO)[6] but he must also determine which of the company's manufacturing and overhead costs must be included in inventory and how they are to be allocated to the various items of inventory. Moreover, a manufacturer's product will typically undergo a major transformation from raw materials or component parts, to work-in-process, to finished goods.

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[5]The difficulty of the judgments involved in an audit of the counting process is, of course, multiplied when one considers the possibility not only of inadvertent client inaccuracies but also of intentional client or employee fraud. An auditor must, for example, wrestle with hard-to-recognize inventory items (jewelry vs. paste; pharmaceuticals vs. empty capsules); with the numerous documents that may confirm or cast doubt on the client's ownership of inventory items; and with countless other counting considerations.

[6]LIFO (last-in-first-out) and FIFO (first-in-first-out) are but two of several generally accepted ways of computing inventory costs; both seek to take into account the fact that a business enterprise will likely purchase raw materials and component parts at differing costs.

The auditor must make innumerable judgment calls (again including utilization of sampling techniques and reliance on company controls) in deciding, for example, which payroll expenditures, electricity charges, plant depreciation expenses, and the like, should be allocated to inventory -- and then in deciding how much of such costs should be allocated to each product category within the inventory. In addition, difficult timing problems must be addressed since a portion of each cost will be properly allocable to items previously in inventory but sold before the balance sheet closing date. A cost accounting system developed in one year, moreover, will have to be carefully adjusted piece-by-piece to reflect the next year's changes in product lines and operating procedures.

But the pricing process is by no means over when the costing is completed, for values based on cost must be adjusted downward when required to reflect market conditions. The auditor must seek to identify defective merchandise -- not only through the frustratingly limited process of physical observation but also by review of customer accounts to detect any unusual degree of returns or credits. More important, the auditor must check for obsolescence -- requiring understanding of product changes throughout the industry. Decisions to write off merchandise may be particularly difficult where obsolescence is signaled not by dramatic changes in technology but rather by changes in customer taste which are not easily discernible.

Equally difficult are judgments to mark down (as opposed to writing off) inventory because of market fluctuations. Even spot-check comparison of historical inventory costs to recent sale prices may not be particularly effective since an auditor is in poor position to tell whether the market can absorb large quantities of such items at recently obtained prices. At best, the auditor will be able, through review of his client's inventory, to identify items which appear to be "moving slowly" and try to make some reasonable assessment -- necessarily relying in part on his client's representations regarding customer response -- as to an appropriate market value for those items having a limited market.

The foregoing, necessarily oversimplified, example of an accountant's professional judgments in testing his client's inventory valuation represents only a small portion of any audit engagement. Numerous other aspects of the accountant's audit will likewise require a series of judgmental decisions, both in the selection of audit procedures to be employed and in evaluating the probative weight of the resulting audit evidence. In the wake of a client's financial collapse, every one of these judgments will be "fair game" for creditors' counsel in seeking to convince the trier-of-fact that the auditor was negligent in not having turned over some additional stone which may have led to material misstatements.

Professional standards recognize that it is impractical to require the auditor to examine every single economic transaction in large business enterprises in order to express an opinion on the financial statements. Consequently, acceptable methods of statistical and nonstatistical sampling of the transactions reflected in the financial statements are authorized by generally accepted auditing standards.[7] Selection of the appropriate sampling techniques requires the auditor to exercise substantial professional judgment. Regardless of how well-founded the auditor's judgments are, imprecision inevitably results from his necessary reliance on selective sampling of the transactions under audit, which makes it impossible for the accountant to find every mistake or deception in the client's records.

2. The Modern Business Enterprise[8]

An analysis of the likely effect of a change in Florida's privity requirement also requires a brief review of

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[7] American Institute of Certified Public Accountants, AICPA Professional Standards AU § 350.07 (1989). This professional standard provides in part:

> Some degree of uncertainty is implicit in the concept of "a reasonable basis for an opinion". . . . The justification for accepting some uncertainty arises from the relationship between such factors as the cost and time required to examine all of the data and the adverse consequences of possible erroneous decisions based on the conclusions resulting from examining only a sample of the data. If these factors do not justify the acceptance of some uncertainty, the only alternative is to examine all of the data. Since this is seldom the case, the basic concept of sampling is well established in auditing practice.

[8] See supra footnote 4.

the array of creditors in a prototype small business -- for example, a necktie manufacturer with sales of only $2 to $3 million per year. Such a company might typically have a lending bank providing it with mortgage financing and another bank extending a general line of credit for the conduct of its business. One can also realistically assume it has entered into a dozen equipment leasing or installment purchase contracts with firms that supply various items of equipment required in the conduct of the company's business (such as machines for cutting, sewing and pressing fabric, trucks for the delivery of finished merchandise, automobiles for its salesmen and executives, lift trucks for moving raw materials within its manufacturing facility, a computer to keep track of its inventory and accounts receivable, and air conditioning equipment to cool its offices and manufacturing facility). It might also have entered into factoring or commercial finance arrangements with credit based on the company's accounts receivable and/or inventory. The list of creditors with potential interest in the company's audited financial statements might also include minority shareholders who made part of their investment in the form of loans.

The foregoing, moreover, describes only those creditors necessary to <u>establish</u> the company's operations; the company must also deal with a host of additional creditors in <u>carrying out</u> its day-to-day operations. The company must buy large quantities of fabric for its neckties, which it will likely obtain from a dozen or more textile mills, as well as large quantities of boxes for which it will likewise have multiple sources. These, of course, would represent only the largest of its trade creditors -- many others would likewise be apt to request either from the company, its accountant, the public files of the Securities and Exchange Commission, or from a credit rating company such as Dun & Bradstreet, a copy of the company's audited financial statements before doing, or continuing to do, business with the company. To this list one would have to add other persons that might do business with the company -- such as the landlord from which it rents its showroom, the garage that services its vehicles, the office supply firm that supplies its stationery needs, the union that represents a unit of its employees, the trucking companies that help transport its goods, and the advertising agency that handles its sales promotions.

The foregoing description, moreover, is of a relatively simple business -- one operating out of a single plant, selling a single product, with a single component. Most businesses issuing audited financial statements are much larger, resulting in an exponential increase in the number of creditors and classes of creditors. It is readily apparent that any concept of a "limited" group of creditors eligible to assert negligence claims is an illusory one.

Without any reference to the nature of the auditing process or the nature of business enterprises, Petitioner and

Investors urge this Court to abolish Florida's privity requirement. This approach ignores the potential impact of such an action by this Court.

B. The Auditor Does Not Have Control Over The Substance Of Financial Statements Analogous To A Manufacturer's Control Over Its Product.

A few courts have compared the auditor's report to a "product" sent into the stream of commerce and have reasoned that, since the privity requirement for products liability has been discarded, liability for accountants similarly should be unrestricted. Gordon, 511 So.2d at 392-93 (Ervin, J., dissenting). However, as Judge Cardozo recognized fifty years ago in deciding MacPherson and Ultramares, important differences exist between the manufacture of a product and the provision of auditing services--differences which render the two fields incomparable for purposes of defining an accountant's duty to third parties.

A manufacturer maintains virtually complete control over the design and production process for its goods--not to mention the ability to affect their distribution. A manufacturer has years to test new products and is able to spread the cost of testing products over all future sales. A manufacturer is thus optimally situated to gauge the extent of his potential exposure to liability and to take such precautions as he deems prudent to minimize his risk. An auditor, however, must take the financial statements as prepared by his client and attempt to express an opinion on their fair presentation in a relatively short period of time, often less than 90 days. Actual control of the substance of financial statements is vested in a management that may, for reasons of its own, actively seek to publish less than accurate financial information. As an outsider, the auditor is never as close to a company's accounting processes as the client's own officers and directors. As set forth above, the nature of business enterprises and the audit process makes it impossible for the auditor to have the control over the financial statement of businesses in the manner that a manufacturer can control his product.

Extension of liability greatly increases the prospects that an auditor may be unfairly held responsible for consequences beyond his control, particularly as a jury may incorrectly conclude that the imprecision resulting from sampling and related accounting judgments is caused by the auditor's lack of reasonable care. Given the auditor's limited control over financial statements, it is illogical and unjust to extend his duty based on an analogy to products liability law.

C. Abolishing Florida's Privity Requirement Does Not Mean That Society Will Benefit.

A central hypothesis offered by many proponents of expanded liability is that the prospect of wide-ranging liability acts as an incentive for accountants to avoid negligence in conducting audits. Citizens State Bank v. Timm, Schmidt & Co., 113 Wis. 2d 376, 335 N.W.2d 361, 365 (1983).

While it is true that the imposition of liability may create some effect on an auditor's professional conduct, the fact that accounting is not an exact science makes it certain that claims for professional malpractice will be significantly increased.

The real issue which must be examined by a court in the context of this policy decision is whether the benefits accruing from any potential increase in deterrence outweighs the social loss of information. While exposing accountants to claims from a larger class of claimants might conceivably generate higher quality information, it would also add substantially to the production and litigation costs incurred by accounting firms. The accountants may thus produce and sell fewer accounting services probably at higher prices. This will result in increased costs to business and in certain accounting firms leaving the market or merging with other firms. If the quantity of information discouraged is large, and the marginal value of the improved quality is small, then expansion of liability results in a net loss to society.[9]

D. Liability Insurance Cannot Be Viewed As A Risk Spreading Mechanism Which Justifies The Substantive Expansion Of Accountants' Liability.

Investors argue equitable loss distribution as the policy justification for extending liability to third parties. Citing a 1969 Rhode Island case, they ask:

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[9] See Point VI and accompanying text for an analysis of why these issues should be addressed by the Legislature rather than this Court.

> Isn't the risk of loss more easily distributed and fairly spread by imposing it on the accounting profession, which can pass the cost of insuring against the risk onto its customers, who can in turn pass the cost onto the entire consuming public?

Investors' Brief p.19, quoting Rusch Factors, Inc. v. Levin, 284 F. Supp. 85, 90-91 (D. R.I. 1968).

Aside from the philosophical problems inherent in such a statement, it certainly is not justification for a change in Florida law in today's liability insurance market. Expanding the liability of accountants will increase both the cost of an audit and the cost of insurance for auditors. Looking to liability insurers to absorb and underwrite this risk is not a viable alternative because liability insurance is not necessarily a readily available commodity in Florida.

Although the social utility rationale for limited liability expressed by Judge Cardozo in Ultramares continues to be cited frequently by courts and was recently reaffirmed in Credit Alliance Corp. v. Arthur Andersen & Co., 493 N.Y.S.2d 435, 483 N.E.2d 110 (N.Y. 1985), and William Iselin & Co.. Inc. v. Mann Judd Landau, 527 N.Y.S.2d 176, 522 N.E.2d 21 (N.Y. 1988), some have come to view it as an anachronism. An implicit assumption made by those who would reject Ultramares is that negligence liability is required in order to protect third parties who rely on the accuracy and fairness of financial statements. If "protection" is defined solely as securing damage awards to compensate for business losses, allowing a third party to recover from a "deep pocket" accountant could admittedly serve this end, since litigation against accountants typically arises in connection with defunct or impoverished companies. However, broader societal interests in encouraging the production and dissemination of information and in promoting efficient--and fair--risk allocation are best served by limiting accountants' liability in accordance with Judge Cardozo's views.

Today, because widely-recognized liability insurance problems have affected the accounting profession by making certain coverages either unavailable or prohibitively expensive, the validity of the assumption underlying the "deep pocket" theory is in question. A dramatic increase in the number of lawsuits against accountants has exerted pressure on insurers.[10] As a result, most insurers have significantly increased their premiums or even withdrawn from the accounting liability market, making affordable coverage increasingly difficult to obtain.[11]

The extended liability advocates who dismiss this problem generally assume that all accountants are in the position of large firms, who they erroneously assume can absorb substantially increased liability insurance premiums. Overlooked are the many smaller accounting firms who increasingly

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[10] Goldwasser, Another Look At Accountants' Liability, Part I, C.P.A. J., (August 1985), at 29.

[11] M. Galen, Litigation Blitz Hits Accountants, 8 Nat'l L.J. No. 40, at 1, Col. 4 (1986).

find themselves able to buy only limited coverage. For all accountants, premiums and deductibles have skyrocketed while maximum coverage has plummeted.[12]

The ultimate result of these spiralling costs is that many accounting firms may be driven from the audit market altogether. This will make it more difficult for smaller companies and start-up firms to afford the audited financial statements needed to obtain credit and transact business. An expansive theory of liability will, in the final analysis, work a substantial disservice to society by reducing competition and raising prices.

Such considerations led at least one court which was asked to reject Ultramares in favor of a more "modern" rule to offer the following rebuke:

> This court hesitates to follow the lead of plaintiffs' counsel who argue that duties be created to favor remote parties because, for example, of the "availability of insurance" to cover the risk. It seems to the court that this makeweight argument really stands the entire question on its head. The standard of behavior ultimately being enforced in such a case is a "duty to buy insurance." Given the currently and widely expressed concerns among . . . legislators about the availability and cost of business insurance and their growing determination to act legislatively in this very area, either by limiting the kinds of claims that might be presented or by

[12] A. Simmons, *International Mortgage Co. v. John P. Butler Accountancy Corp.: Third Party Liability--Accountants Beware*, 18 Pac. L.J. 1055, 1067 (1987).

> adjusting the premiums which might be charged, this court feels that it is most inappropriate for it to be creating "new torts" at this time,...

Robertson v. White, 633 F. Supp. 954, 970 (W.D. Ark. 1986). This Court should curtail the tendency toward risk distribution among the public at large by upholding the current rule of accountants' liability in this State.

Furthermore, banks and other lending institutions are in a far better position than accountants to insure against loan losses. Banks have traditionally conducted their business in such a way as to compensate themselves for bearing the risk that the borrower will default on its obligations, irrespective of the cause of the default. Financial institutions typically base their charges on the amount of credit being extended. Accordingly, the larger the amount being borrowed, the greater the lender's total compensation. In addition, finance charges are also directly affected by the perceived degree of risk involved in making the loan.

In sharp contrast to the practices of financial institutions, accountants typically charge for their services on the basis of the number of professional hours worked, without any additional compensation to reflect those instances in which their clients have large credit lines. Indeed, due to competitive pressures within the accounting profession, the auditor does not receive additional compensation either for the risk associated with the credit of his client or for their potential defaults.

Investors also argue that accountants should be liable to third parties for negligently prepared reports because "the third-party recipients of such data often are 'unable to take steps independently to protect [themselves] against the consequences of the negligence of the [accountant].'" Investors' Brief, p. 14. Such statements, however, are certainly not true in the present case. Large lending institutions, like the Petitioner, routinely check the local credit bureau, Dun & Bradstreet, verify references from suppliers and other banking institutions, obtain copies of past tax returns, check UCC filings and lis pendens, and require collateral. There is certainly no reason to change the law of Florida to shift the liability for a bad loan from the Bank to Max Mitchell on the grounds that the Bank has no way to protect itself.

Public policy requires that risk be placed on those who, through their own actions, are in the best position to reduce that risk. If the privity requirement is abolished for accounting malpractice actions, creditors will reduce their own efforts to protect themselves, resulting in an explosion of lawsuits and a decrease in the availability and affordability of audit services since creditors will instead rely on the "deep pockets" of accountants and their insurers. As creditors take less steps to protect themselves and more lawsuits are filed, it is inevitable that additional insurance problems will result, this time for accountants and their services. If analogized to the problems that have occurred in the medical and child care professions, then businesses might expect the same problems in obtaining audit services. Clearly, public policy in this instance is best served by retaining the privity requirement.

POINT IV

ALTHOUGH VARIOUS STATES HAVE ADOPTED DIFFERENT APPROACHES TO ACCOUNTING MALPRACTICE, FLORIDA'S APPROACH REMAINS VALID AND SHOULD BE RETAINED.

Both Petitioner and Investors seek an extension of liability to third parties not in privity with an accountant who is providing services to his client. The breadth of the extension that each seeks, however, appears to be substantially different.

Petitioner appears to be seeking to extend liability to those third parties whom an accountant actually induces to rely on certain financial statements. There is nothing in this record, however, to indicate that Petitioner and Respondent had any contact prior to the time the audit was completed. Petitioner, therefore, ignores the issue of whether it was a known and "intended beneficiary" at the time the parties entered into the contract for audit services or when the audit was performed.[13] Investors want to expand liability much further to

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[13]An important aspect of Florida's privity requirement in other areas of law is that it requires the relationship of the third party to the service provider to exist at the time the service provider and his client agree as to the services to be provided and the service is performed. Goldbera, Semet. et al.

include various classes of potential users of accountants' statements.

Investors state that there are three general standards that courts in other states apply in actions against accountants by a third party. The distinctions between these standards, however, are blurred by various courts and their application to the facts of the various cases they have considered. The first standard (the Investors' "strict privity") allows negligence actions only by parties in privity of contract or in a situation "so close as to approach that of privity." The second standard is that set forth in Section 552 of the Restatement (Second) of Torts, which creates a cause of action for a person or a limited class of persons whom the auditor knows or can actually foresee as parties who will and do rely upon negligently prepared financial statements. Finally, the third standard, the "reasonably foreseeable" standard, permits a cause of action by all parties who are reasonably foreseeable recipients of financial statements and who rely on the statements for those business purposes. Each of these general approaches is discussed below.

V. Chicaao Title Insurance Co., 517 So.2d 43, 45 (Fla. 3d DCA 1987).

A. Privity Continues To Govern Accountants' Liability In New York And Has Been Affirmed By Other States In Recent Years.

The privity requirement is still viable in a number of jurisdictions. Investors' statement that "virtually every court faced with a situation akin to that at bar has distinguished Ultramares and has held an accountant liable for negligence to those whom he knows, or reasonably should know, will rely on it's work product" is simply untrue.

The privity rule, explained by Justice Cardozo in the much cited Ultramares, allows actions in negligence only by parties in privity of contract or in a situation "so close as to approach privity." 174 N.E. at 446. Despite Petitioner and Investors' assertion to the contrary, the privity rule has been adopted or reaffirmed by other states in recent years. See e.g. Credit Alliance Corp. v. Arthur Andersen & Co., 483 N.E.2d at 118 (N.Y. 1985) ("general" or "predominant" rule denies recovery to nonprivity reliant parties).

In 1985, New York's highest court reaffirmed the holding in Ultramares and specifically stated it was not departing from the principles, wisdom or policy set forth in that landmark decision. Credit Alliance, 483 N.E.2d at 114-15. In Credit Alliance, the court was faced with defining exactly what situations would be "so close as to approach privity" or the equivalent of privity. The court set forth the following prerequisites that must be satisfied before accountants could be liable to noncontractual parties who rely to their detriment on inaccurate financial reports: (1) the accountants must have been aware that the financial reports were to be used for a particular purpose or purposes; (2) in the furtherance of which a known party or parties was intended to rely; and (3) there must have been some conduct on the part of the accountants linking them to that party or parties which evinces the accountants' understanding of that party or parties' reliance. Credit Alliance, 483 N.E.2d at 118.

Likewise, in Robertson v. White, 633 F.Supp. 954 (W.D. Ark. 1986), a federal court applying Arkansas law refused to permit a suit in negligence against accountants by third party creditors even though the accountants had knowingly mis-represented the financial solvency of the audited entity. The accounting firm gave an unqualified opinion of the co-op's status and presented the same at the co-op's annual meeting. Id. at 963.

Just recently, in Idaho Bank & Trust Co. v. First Bancorp of Idaho, 772 P.2d 720 (Id. 1989), the Idaho Supreme Court rejected plaintiff's suggestion that the court permit nonprivity parties to bring accounting malpractice actions. The court instead adopted the privity requirement of Ultramares as explained in Credit Alliance. Id. at 721.[14]

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[14] A number of other courts have recently adopted or reaffirmed the Ultramares holding. See e.g. Toro Co. v. Krouse, Kern & Co., Inc., 827 F.2d 155 (7th Cir. 1987) (federal court maintains privity or near privity in accountant cases based on Indiana's recent rejection of Restatement standard for

Additionally, the state legislatures of Arkansas, Illinois and Kansas have recently passed statutes which maintain privity and set forth very strict requirements regarding how privity may be created with third parties.[15] These statutes all require the accountant to be aware that the primary intent of the audit is to benefit or influence a third party and this awareness must be made known in writing. Wyoming passed a similar law in 1988 only to have the Governor veto the bill.

Thus, based on the above developments, it appears that the privity rule, as set forth by Justice Cardozo, continues to be widely followed. Nothing in the record shows that Max Mitchell was in privity with Petitioner or even knew prior to performing the audit that the audit would be supplied to Petitioner.

B. The Restatement Standard Which Limits Liability To Specifically Foreseen Users Of Accounting Information Is Overly Broad.

Several states, including Rhode Island, have adopted an approach that allows a non-privity plaintiff to recover against an accountant for negligence. In Rusch Factors, Inc. v. Levin,

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surveyors); Merit Insurance Co. v. Colao, 603 F.2d 654 (7th Cir. 1979), cert. denied, 445 U.S. 929 (1980) (applying Illinois law); McLean v. Alexander, 599 F.2d 1190 (3d Cir. 1979) (applying Delaware law); and Hartford Acc. and Indemnif. Co. v. Parente. Randolph, 642 F. Supp. 38 (M.D. Pa. 1985).

[15] See Arkansas Statute § 16-114-302 (1987); Illinois Rev. Statute, Ch. 111, § 5535.1 (1987); and Kansas Corp. Code Ann. § 1-501 (Vernon 1987).

284 F. Supp. 85 (D. R.I. 1968), a federal district court utilized the newly drafted Restatement of Torts which permits recovery to those who are actually foreseen as parties who will and do rely upon the financial statements.

The Restatement Rule differs substantially from the privity rule as explained in Credit Alliance in that the Restatement position allows recovery by an unidentified third party as long as the third party is a member of an identified class of persons whose reliance the accountant can foresee. Restatement (Second) of Torts §552 comment h (1977). Although most states adopting the Restatement position require the accountant to know of or actually foresee the relying person or limited group, one Texas court has held constructive knowledge is sufficient. Blue Bell, Inc. v. Peat, Marwick, Mitchell & Co., 715 S.W.2d 408 (Tex. Ct. App. 1986). Thus, in Texas a relying third party need only prove the accountant should have known of his reliance. Such an interpretation makes the Restatement virtually indistinguishable from the reasonably foreseeable standard discussed below.

Furthermore, in the course of the normal audit process, the accountant will come across the names of virtually all of his client's creditors. Therefore, the scope of potential persons encompassed by the proposed changes to Florida's privity requirement is not limited in any meaningful way by the requirement that the defendant accountant have been aware of the existence of the plaintiff creditors. Many auditors customarily review their clients' lists of accounts payable. With respect to major creditors (such as banks, doctors, large suppliers, equipment lessors and related party lenders), it is common for the auditor to obtain direct confirmation of the company's outstanding balance. In addition, auditors will normally review commercial agreements and documents concerning material transactions. Auditors also customarily perform "Cut-off" procedures consisting of a review of payments made by the company, surrounding the beginning and end of the accounting period under audit, in order to ascertain whether transactions are allocated to their proper accounting period.

In view of these basic audit procedures, there will typically be a host of potential plaintiffs in a position to argue that the auditor knew or should have known of their existence and therefore could have "foreseen" the possibility of their requesting and obtaining financial information regarding the company (including the auditor's report).

To be sure, not all creditors are equally likely to inspect the audited financial statements of a company. However, there is no way for an auditor to foretell which creditor may choose to do so or which one actually did. In any case, the chief beneficiaries of such a change in Florida's privity requirement would be large creditors such as banks and similar financial institutions. These entities are the least in need of additional protection.

Relaxation of the privity rule would, in essence, result in its abrogation. Every creditor or lending institution would attempt to conform its lending procedures so that it would fit within the relaxed rule. This might be accomplished by something as simple as sending, on an annual basis, a postcard to a debtor's accountant indicating that it intended to rely upon the accountant's audit for future loan requests by the debtor. Because creditors and other lending institutions would change their procedures so as to acquire the "deep pockets" of accountants and their insurers, accountants would be exposed to innumerable lawsuits, all arising out of the same audit. Moreover, because the question of whether each entity actually fit within the relaxed rule would involve a question of fact, the cost of defending such litigation would be staggering. By relaxing the privity rule, accountants and their insurers will be driven out of the field just as if the rule had been abrogated in its entirety.

In sum, the rule of law proposed by Petitioner and Investors, and apparently embraced without adequate appreciation of its complications, would be a major change in the law of Florida.

C. The Reasonably Foreseeable Standard Articulated By Investors Would Involve A Wholesale Departure From The Privity Requirement Of Florida Law And Has Been Rejected By This Court.

In H. Rosenblum, Inc. v. Adler, 93 N.J. 324, 461 A.2d 138 (1983), the New Jersey Supreme Court set new precedent by expanding the liability of accountants to all reasonably foreseeable third parties who rely on audited financial statements. This reasonably foreseeable test, which Amici state has been adopted in "many of the cases" has, in fact, been adopted in only three states: **Mississippi**[16], New Jersey, and Wisconsin. **See** Touche Ross & Co. v. Commercial Union Ins. Co., 514 So.2d 315 (Miss. 1987); H. Rosenblum, Inc.; Citizens State Bank v. Timm, Schmidt & Co., 113 Wis. 2d 376, 335 N.W.2d 361 (1983). One appellate court in California also adopted the reasonably foreseeable standard in International Mortsase Co. v. John P. Butler Accountancy Corp., 233 Cal. Rptr. 218, 177 Cal. App. 3d 806 (1986).

In Rosenblum, the New Jersey court spoke of balancing the burdens and risks between plaintiffs and defendants. Id. at 147. The court believed the "availability" and the "prevalence of liability insurance" made it more desirable and effective to allocate the incentive to insure to the accounting profession. The court was particularly persuaded by a 1976 report that indicated "accounting firms had little difficulty in obtaining insurance at reasonable cost." 461 A.2d at 151, fn. 11. In 1976, this may have been true in New Jersey, but as stated more fully in Point VI of this brief, that is not the

[16]**Mississippi's** highest court felt compelled to adopt the broad standard because a Mississippi statute has been enacted that abolished the privity requirement for all service providers.

case in Florida.[17]

This broad "reasonably foreseeable" standard was specifically rejected by this Court in First American Title Insurance Co. v. First Title Service Co. of the Florida Keys, 457 So.2d 467 (Fla. 1984). Furthermore, it has been rejected by this Court in the context of other professional services, and no reason exists for adopting it here. See e.g. Ansel, Cohen & Rogovin v. Oberon, Inc., 512 So.2d 192 (Fla. 1987) (attorneys).

POINT V

THE PRIVITY REQUIREMENT CANNOT BE CIRCUMVENTED BY ALLEGING GROSS NEGLIGENCE.

Petitioner argues in its second point that a lender has a cause of action for gross negligence against the accountant regardless of whether the bank is in privity with the accountant. Petitioner cites Canaveral Capital Corp. v. Bruce, 214 So.2d 505 (Fla. 3d DCA 1968), and Investors Tax Sheltered Real Estate, Ltd. v. Laventhol, Krekstein, Horwath and Horwath, 370 So.2d 815 (Fla. 3d DCA 1979), cert. denied, 381 So.2d 767 (Fla. 1980), as supporting a cause of action for gross negligence. Both of these cases, however, cite Buchman as authority for this proposition, and when one examines the Buchman opinion it is clear that the cause of action is really fraud which can

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[17]See also, M. Galen, Litigation Blitz Hits Accountants, 8 Nat'l L.J. No. 40, at 1, Col. 4 (1986).

be proved by a showing of gross negligence. See Buchman, 208 So.2d at 292 ("... the trial court instructed the jurors that if they found that defendants were grossly negligent in preparing the certified statement then the jurors could infer fraud on the part of the defendants."). This language does not create a separate cause of action for gross negligence, but merely states that evidence of gross negligence is one way for a plaintiff to prove fraud. In such a case, however, the plaintiff must plead a cause of action for fraud.

There is nothing unique about this principle of law. In Ultramares, Justice Cardozo held that gross negligence or blindness, even when not equivalent to fraud, is nonetheless evidence to sustain an inference of fraud. 174 N.E. at 449. See also State Street Trust v. Ernst, 15 N.E. 2d at 419 (1938) ("A refusal to see the obvious, a failure to investigate the doubtful, if sufficiently gross, may furnish evidence leading to an inference of fraud . . . ") (emphasis added). Likewise, in Florida, evidence of gross negligence has always been allowed to be introduced to infer fraud. See e.g. Watson v. Jones, 41 Fla. 241, 25 So. 678 (1899) (fraud may be proven where the statement is recklessly or carelessly made).

Petitioner has asked this Court to establish a whole new theory of liability predicated solely upon gross negligence. This Court should decline that request.

POINT VI

THIS COURT SHOULD DEFER TO THE LEGISLATURE ON A CHALLENGE TO A LONG SETTLED RULE OF COMMON LAW INVOLVING CRITICAL CONSIDERATIONS OF PUBLIC POLICY AND TORT LIABILITY.

The issue before this Court is one of great public importance. See First American Title Ins. v. First Title Service Co., 457 So.2d 467 (Fla. 1984) (extension of abstractor's liability to third-parties is a public policy question). Because the issue in this case addresses significant public policy in the area of tort reform, this Court should proceed cautiously to avoid encroaching into an area which may be better left to legislative determination. While this Court may determine public policy in the absence of a legislative pronouncement, any judicial policy-making must yield to legislative will, and courts are bound to give "great weight" to legislative determinations of fact. VanBibber v. Hartford Accident & Indemnity Ins. Co., 439 So.2d 880 (Fla. 1983).

Florida is currently in the throes of a tort crisis stemming from the affordability and availability of liability insurance that is directly attributable to the proliferation of litigation. Academic Task Force for Review of the Insurance and Tort System, Final Fact-Finding Report, p. 22, (1988) (available at the Supreme Court Library). In response to this crisis the Florida Legislature established the Academic Task Force for Review of the Insurance and Tort Systems (hereinafter

"Academic Task Force") to study these problems. The Academic Task Force was charged with the responsibility of ascertaining the causes of these problems and reporting back to the legislature its findings and recommendations.

After an exhaustive two-year study, the Task Force published a two-volume report setting forth its Findings of Fact and Recommendations. The major findings of the Academic Task Force regarding Florida's insurance and tort systems are set forth in part as follows:

> 1. Affordability. The price of liability insurance in Florida has increased at a rate substantially in excess of inflation since 1981. The degree of price increases has varied markedly with the type of coverage, and the price increases were concentrated in the years 1984 through 1986.
>
> 2. Availability. Although availability problems have not been as pervasive as affordability problems, Florida insureds have been unable to obtain specific types of liability coverages during selected time periods. In a wider variety of coverages, insureds were unable to obtain new coverages or coverages with the policy limits and limited exclusions they desired.[18]
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> 3. Causes of Price Increases. The primary cause of increased liability insurance premiums has been increases in the amounts insurers have paid for claims and legal defense costs, and increases in the amounts they estimate will be necessary to pay

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[18] Availability does appear to be a problem with regard to accounting malpractice insurance. See p. 29, *supra*.

claims and legal defense costs in the future.

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12. Explanations for Increased Litigation. The increase in litigation frequency rates in the sate of Florida probably results from subtle cultural changes which make it more likely that injured parties will pursue litigation, changes in the law which benefit plaintiffs and an increase in the total number of tortious injuries in Florida as the population increases and the economy expands.

13. Changes in the Law. There has been an unmistakable trend toward the expansion of tort liability during the past twenty years in most areas of tort law (other than medical malpractice) both in Florida and throughout the country. These changes in tort law are a major contributing cause of the increase in total loss payments and the resulting liability insurance affordability problems. Insurers' concerns over future expansion of liability also contribute to availability problems. (Emphasis added.)

Id. at 1-5, 13-15.

While the Task Force made several specific recommendations to the Legislature to alleviate perceived problems with the tort system, the overriding recommendation was to encourage the Legislature and courts to stabilize the legal environment and make no further revisions to the tort system for at least five years. Academic Task Force for Review of the Insurance and Tort System, Final Recommendations, p. 183-186 (1988). Only with some stability in the legal arena can insurance companies effectively predict losses and offer coverage. Id.

The purpose of abolishing the privity requirement in accounting malpractice actions is to expand the number of plaintiffs in accounting malpractice actions. Increased litigation is the only possible result of such actions. The resulting increase in litigation will increase legal defense costs and claims paid, thus placing further strain on the tort system and insurance liability crisis. This drastic step should not be taken when the Florida Legislature is attempting to restrain increases in litigation.

In fact, an analysis of the policy issues discussed in this Brief, including the nature of the auditing process, the impact on accountants and businesses of third party liability, the cost and availability of insurance, and the quality of accounting services, requires statistical evaluation, evidentiary support of various types, including testimony from the insurance industry, creditors, investors, and accountants. These are the types of issues and facts which should be explored in a legislative setting.

This Court should unequivocally reaffirm the strict privity requirement that has long been the law of this state and leave proposed expansion of such liability to the Legislature. "A change so revolutionary, if expedient, must be wrought by legislation." Ultramares, 174 N.E. at 447.

CONCLUSION

Under Florida law accountants do not have third-party liability to third parties with whom they are not in privity. Petitioner and Respondents have presented no compelling reason for this Court to impose a legal duty on accountants to third parties who are not their clients. Absent such a compelling reason, this Court should not consider changing the present privity requirement in actions involving accountants.

Without such third-party liability, commercial activity in Florida appears to be operating in a desirable way. The banking industry appears healthy and is certainly growing in Florida. There are no complaints from borrowers of a lack of access to capital. There is no evidence before this Court that businesses have difficulty raising capital or that investors are unable to find investment opportunities. There is no evidence of concern on the part of the public regarding the liability of accountants, no evidence of proposed legislation, or newspaper editorials calling for change.

Regardless of the extent of commercial activity in Florida, there is relatively little litigation in this area. In fact, Investors assert that this is a case of first impression for this Court. After years of extensive commercial activity, this lack of activity also demonstrates there is no compelling reason for change.

The Florida Institute of Certified Public Accountants respectfully requests this Court to maintain the current requirements of Florida law regarding the liability of accountants to third parties who are not their clients.

DATED this 26th day of June 1989.

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ATTORNEYS FOR FLORIDA INSTITUTE
OF CERTIFIED PUBLIC ACCOUNTANTS

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been furnished by U.S. Mail to Robert W. Clark, Esq., MacFarlane, Ferguson, Allison & Kelly, Post Office Box 1531, Tampa, FL 33601; John N. Jenkins, Esq., The Bayshore Bldg., Suite 201, 2907 Bay to Bay, Tampa, FL 33629-8154; and Michael A. Hanzman, Esq., Floyd Pearson Richman Greer Weil Zack & Brumbaugh, P.A., CourtHouse Center, 26th Floor, 175 N.W. First Avenue, Miami, FL 33128-1817 this 26th day of June 1989.

Kenneth Hart

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