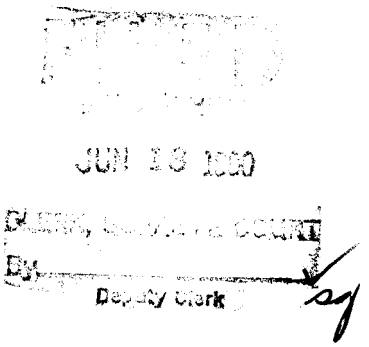
SUPREME COURT OF FLORIDA

CASE NO. 75,529



PANNELL KERR FORSTER,

Petitioner,

vs.

VAUGHN DURHAM, et al.,

Respondents.

RESPONDENTS' BRIEF ON THE MERITS

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STATEMENT OF THE CASE AND OF THE FACTS

Respondents are approximately seventy (70) individuals who purchased one or more condominium hotel units in a project known as the "Palm Court Hotel". (A - 43).[1] The hotel interests were marketed pursuant to the terms of a confidential private placement memorandum dated June 30, 1985, as amended by an addendum dated October 15, 1985 ("PPM"). (A - 46, A - 122). Included in the PPM is a "Market Demand Report" and a "Financial Forecast and Financial Projections" prepared by Petitioner, the accounting firm of Pannell Kerr Forster ("PKF"), which holds itself out as specializing in matters pertaining to the resort industry. (A - 89, A - 240, A - 410).[2]

In their Counterclaim against PKF, Respondents allege that PKF provided the seller of the hotel interests with express permission to include both the "Market Demand Report" and the "Financial Forecast and Financial Projections" as exhibits to the offering memorandum. (A - 89). Respondents also allege that at all material times PKF had actual knowledge of the fact that the reports it was retained to prepare would be included in the offering memorandum used to market the investment. (A - 89).

As their claims against PKF, Respondents allege that in

[1] The Respondents will cite the Appendix to the Petitioner's Brief on the Merits as "A (page number(s))".

[2] Exhibit "A" to the PPM entitled "Pannell Kerr Forster Market Demand Report" contains six (6) sections. It is found at Petitioner's Appendix, pp. 240 - 296. Exhibit "C" to the PPM is a "Financial Forecast and Financial Projections". It is contained in Petitioner's Appendix, pp. 410 - 432.

connection with the preparation of the "Market Demand Report" and the "Financial Forecast and Financial Projections", "PKF breached its duty of care to the Purchasers by negligently compiling the data necessary to forecast the market demand and financial forecast for the Hotel, and by negligently analyzing the data which was compiled." (A - 90). Respondents further allege that as a result of PKF's failure to exercise the care and skill that a prudent professional would exercise under the circumstances, the reports prepared and contained in the offering memorandum were grossly inaccurate even assuming the assumptions underlying the studies had come into fruition. (A - 90). These allegations are contained within the Respondents' count against PKF for "Negligence."

Additionally, in a claim for "Gross Negligence", Respondents allege that prior to the time the Palm Court offering was consummated, PKF obtained actual knowledge that its studies were not reliable due to numerous changes in conditions that had occurred between the time they were completed and the fall of 1985, approximately two (2) months prior to the closing. (A - 90). In particular, Respondents allege that PKF knew that many of the assumptions on which its studies were based did not, and in fact would not come into fruition, and it knew that the proposed management of the hotel would be unable to provide the type of service which was necessary in order for the PKF studies to remain valid and an accurate forecast for hotel operations. (A - 90, 91). It is alleged that despite this knowledge PKF took absolutely no action whatsoever to modify its studies, nor did it direct the

sponsor of the offering to cease using the studies as a basis for marketing the offering. (A - 91).

On June 8, 1988 PKF filed a Motion to Dismiss Respondents' Counterclaim raising the following four (4) grounds: (1) "No Allegations of Reliance" (A - 34); (2) "Impermissible Reincorporation of Prior Counts" (A - 34); (3) "Insufficiency of Process or Service of Process" (A - 34); and (4) Lack of Privity of Contract between PKF and the investors. (A - 33-39). After entertaining argument on the motion, the trial court entered an order dated October 24, 1988, dismissing Respondents' Counterclaim against PKF with prejudice on the basis that "Florida law denies relief for a breach of due care by an accountant to third parties who are not in privity with that accountant, even though reliance by the third parties is known or anticipated." (A - 120, 121, citing Gordon v. Etue, Wardlaw & Co., 511 So.2d 384 (Fla. 1st DCA 1987)).

On January 4, 1990 the Fourth District Court of Appeal reversed the order dismissing the Respondents' Counterclaim. (A - 551-557). In its opinion the Fourth District addressed only one issue; namely - whether Respondents' claims against PKF failed to state a cause of action due to the absence of an allegation of contractual privity. The court answered that question in the negative, and acknowledged that its holding conflicted with Gordon, supra, and the Second District's decision in First Florida Bank v. Max Mitchell & Co., 541 So.2d 155 (Fla. 2d DCA 1989). As a result, Petitioner filed its "Notice to Invoke Discretionary Jurisdiction of Supreme Court" on the grounds that the decision below expressly and directly

conflicted with decisions of other district courts of appeal on the same question of law (A - 558) - whether privity was required in order tomaintain claims for negligence and gross negligence against accountants. See Petitioner's Jurisdictional Brief.

Subsequent to the submission of the parties' jurisdictional briefs, this Court issued its opinion in First Florida Bank, N.A. v. Max Mitchell & Co., 558 So.2d 9 (Fla. 1990), and held that the absence of privity does not bar an action against an accountant. Id. at 14. This Court nevertheless issued an order on April 24, 1990 accepting jurisdiction in this matter and dispensing with oral argument. (A - 569).

Recognizing that this Court's opinion in First Florida Bank eliminated the conflict of decisions on which this Court's jurisdiction was initially based, Petitioner has, in its brief on the merits, abandoned any argument that the Respondents' pleading is deficient for failure to allege privity of contract. Rather, Petitioner now argues in this Court that because its economic forecasts were "mere opinions of future events, not statements of present or past fact, as a matter of law they are not actionable, and they cannot render PKF liable to Respondents." Petitioner's Brief on the Merits, P - 10.

ISSUE 1: **WHETHER THIS COURT SHOULD ADDRESS PETITIONER'S ARGUMENT ON THE MERITS**

ISSUE 2: **WHETHE THE RESPONDENTS' COUNTERCLAIM AGAINST PKF STATES A CAUSE OF ACTION**

SUMMARY OF ARGUMENT

The argument that Respondents' Counterclaim fails to state a cause of action on the grounds that the PKF studies were mere opinions of future events was never raised in the trial court or addressed by the Fourth District Court of Appeal. Accordingly, this Court should not be the first tribunal to deal with this issue because (a) it has no jurisdiction to do so, and (b) it has long been recognized that the Supreme Court will not review matters which lower courts have not had an opportunity to consider.

Furthermore, even if this Court were to decide to address the argument raised by Petitioner, the contention that Respondents' Counterclaim does not state a cause of action because the economic forecast are mere opinions of future events is frivolous. The decisions PKF relies upon which stand for the proposition that a prediction of future events cannot, standing alone, be a basis for fraud, have nothing to do with the issue in this case. Here Respondents are not suing PKF for fraud based upon the allegation that it knew its reports were unreliable at the time issued. They are suing PKF for negligence in the preparation of the reports; that is, the failure to use the degree of care which would be followed by a competent professional specializing in the business of preparing such forecasts, as does PKF.

Respondents are also suing PKF for failing to take corrective measures with respect to its forecasts after it had actual knowledge of the fact that its forecasts were totally unreliable.

Accordingly, the decisions relied upon by PKF simply have nothing to do with the case at hand, and the allegations raised by Respondents state a cause of action.

ARGUMENT

I. THIS COURT SHOULD NOT ADDRESS THE ISSUE RAISED BY PKF IN IT8 BRIEF ON THE MERITS.

As previously mentioned, the onlv argument raised by PKF in its brief on the merits is the contention that because its economic forecasts were opinions of future events, they are not actionable as a matter of law. This argument was never raised in PKF's motion to dismiss filed in the trial court. (A - 33-39). Furthermore, it was never even mentioned, let alone addressed, by the Fourth District Court of Appeal. (A - 551-557). Accordingly, this Court does not have subject matter jurisdiction to entertain that argument here.[3]

Moreover, despite the jurisdictional obstacle, this Court has consistently maintained that it should decline to review questions which the trial court did not have a full and adequate opportunity to consider. In re Beverlv, 342 So.2d 481, 489 (Fla. 1977) ("This Court should decline the review of questions which the trial court did not have a full and adequate opportunity to consider"); Dober v. Worrell, 401 So.2d 1322, 1323, 1324 (Fla. 1981) ("appellate court

[3] As pointed out in our pending "Motion to Dismiss Appeal for Lack of Subject Matter Jurisdiction" the Fourth District's opinion below certainly does not "expressly and directly" conflict with any decision on the point of law now being argued by the Petitioner, since the opinion below never mentions the issue now being advanced.

will not consider issues not presented to the trial judge either on appeal from an order of dismissal, or on appeal from final judgment on the merits". Citations omitted). As this Court made clear in Lipe V. City of Miami, 141 So.2d 738 (Fla. 1962):

> The record is devoid of a single fact which would indicate that this question was ever before the trial court. It is a rule of longstanding that on appeal this Court will confine itself to a review of those questions, and only those questions, which were before the trial court. Matters not presented to the trial court by the pleadings or ruled upon by the trial court will not be considered by this Court on appeal.

Id. at 743. (Emphasis added). See also, Northeast Polk County Hospital District v. Snively, 162 So.2d 657 (Fla. 1964) (Supreme Court is required to review only that which trial judge has had an opportunity to consider).[4]

Although this Court has departed from the above-referenced rule in order to address fundamental questions of law, such as questions regarding the constitutionality of a statute, see e.g., Cantor V. Davis, 489 So.2d 18 (Fla. 1986); Trushin v. State, 425

[4] Once this Court accepts jurisdiction over a cause in order to resolve the legal issue in conflict, it may, in its discretion, "consider other issues properly raised and argued before this Court." See Savoie v. State, 422 So.2d 308 (Fla. 1982) (Supreme Court would consider whether trial judge correctly denied motion to suppress on the merits, even though the district court affirmed trial court on a waiver theory and refused to consider the denial on the merits). See also Neuron v. State, 306 So.2d 104 (Fla. 1974) (after the conflict of decisions became apparent, we were at liberty to consider the case as a whole, including the transcript). These decisions, however, stand only for the proposition that this Court's review of a case is not limited to the question which forms the basis of conflict jurisdiction. They do not stand for the proposition that this Court should consider questions never raised in the trial court.

So.2d 1126 (Fla. 1983) (conviction for the violation of facially invalid statute would constitute fundamental error), it has not done so in a situation such as that at bar, where Petitioner has raised on appeal for the first time a typical, non-fundamental legal argument which was never addressed in the trial court. On remand Petitioner will certainly have an opportunity to make this argument, and the trial court will rule upon it. In the event Petitioner is dissatisfied with the trial court's decision, it may take an appeal of that decision at the appropriate time and address its arguments to the appellate court. Then, if the decision of the appellate court provides Petitioner with a basis upon which to seek review in this Court, it may do so. However, at this point neither the trial court nor the appellate court has addressed this question, and they should be given an opportunity to do so. For this reason alone, this Court should simply remand this matter to the trial court for further proceedings.

II. TEE RESPONDENT COUNTERCLAIM AGAINST PKF STATES A CAUSE OF ACTION.

In its brief on the it r c cites im c s: standing or the i that a "misrepresentation must ordinarily relate to a ı or i ·t to be the basis of a claim for relief soundi in fraud." See leight v. Sun and Surf Realt· Inc., 410 So.2d 998 (Fla. 3d DCA 1982); Evans v. Gray, 215 d 40 a 3d DCA 1968) (sellers alleged misr i as to the credit ut of the company not onab as f Butts v. Draastrem, 349 d 1. (Fla. 1st DCA 1 tions as to probable ture profits of trailer park made by seller in connection ith the of a trailer park d : constitute l fraud); Cavic v. Grand Bahama Dev. Co., 701 F.2d 879 1th 1983 (a : ı s e of t action or predi : of future events cannot, standing alone b a i for fraud The basis for this rule is that a predicti of future event "is ı ı representat ıer is n t to rely on it and it is not l made." _____, supra, at 883

Respondents have absolutely no quarrel w the bove-referenced pri of aw In our opinion the rule is both sound a s sett I ı er l has nothing to do w l th s presented in this case since Respondents are not alleging that the ı prepared l PKF t t t f dul representations. What we do lege is that the report were negligently prepared. That is, ı l that the accountants, l were t s retained to e the reports, d t exercise the care and skill that

a prudent professional would exercise under the circumstances in compiling the data and formulating the studies. (A - 90). In other words, it is our position that the accountants committed malpractice. No one has sued them for fraud based upon the allegation that the studies constituted a representation of existing fact which the accountants knew was incorrect at the time it was made. Thus, unlike the situation presented in the decisions relied upon by Petitioner, we are not dealing with a case where a seller of a business is being sued based upon the allegation that he or she misrepresented the business' future earning capacity. Rather we are again involved in a case where an accounting firm, which holds itself out as an expert in preparing market demand reports and feasibility forecasts, is being sued by persons who relied upon those forecasts, based upon the contention that they were negligently prepared. Consequently, the rule that predictions of future events cannot form the basis of an action for fraud, has nothing to do with the issue at hand.

If PKF's assertion that it is insulated from liability because its forecasts were predictions of future events (as opposed to existing fact) is accepted by this Court, it will mean that accountants retained to prepare such studies are absolutely, under **all** circumstances, immune from suit. Thus, a party could retain an accounting firm which held itself out as an expert in preparing such studies, pay the accounting firm substantial monies for the preparation of the studies, and be left without any remedy against the accounting firm in the event it failed to exercise even the

slightest degree of care in compiling the data and putting together the report. Obviously this is not the law, and Petitioner's reliance upon the above-referenced rule in order to attempt to insulate itself from liability under these circumstances is severely misplaced.

Equally misplaced is Petitioner's reliance upon the cases it cites decided under the federal securities laws. Each of those cases stands for the same proposition as the Florida cases set forth above. Stated differently, they each involved a situation where a party was suing either the seller of the securities or the accounting firm for securities fraud based upon alleged "intentional misrepresentations as to the potential cash and tax benefits of the partnership". Luce v. Edelstein, 802 F.2d 49, 56 (2d Cir. 1986). See also Nichols v. Merrill Lynch, Pierce, Fenner & Smith, 706 F.Supp. 1309, 1327 (M.D. Tenn. 1989) (accounting firm could not be held liable for securities fraud (i.e., 10(b)-5) based upon its preparing estimates of future rental income, since "it is by no means clear how Laventhal could have had scienter, since it was predicting a future event"); Andreo v. Friedlander, Gaines, Cohen. Rosenthal & Rosenberg, 651 F.Supp. 877 (D. Conn. 1986) (plaintiffs claimed that accountants were part of a scheme to defraud them in violation of the federal securities laws and the federal racketeering statute); In re National Smelting, 722 F.Supp. 152 (D.N.J. 1989) (accounting firm hired to audit a startup balance sheet of company could not be held liable for misrepresentation under 10(b)-5).

What can be gleaned from the above cases is that they are merely an application (in a securities setting) of the rule that a prediction of future events cannot constitute actionable fraud or misrepresentation. This is made clear by the court's discussion in the case of Isquith v. Middle South Utilities, Inc., 847 F.2d 186 (5th Cir. 1988):

> Courts in the past have consistently recognized that a defendant does not place itself beyond the reach of the securities laws merely by disclosing information that is predictive in nature. For example, when necessary, courts have readily conceded that predictions may be regarded as "facts" within the meaning of the anti-fraud provisions of the securities laws. See Marx v. Computer Sciences Corp., 507 F.2d 485, 489 (9th Cir. 1974); Abrams v. Oppenheimer Gov't Sec., Inc., 589 F.Supp. 4, 9 (N.D. Ill. 1983); Eichen v. E.F. Hutton & Co., 402 F.Supp. 823, 829 (S.D. Cal. 1975). Most often, whether liability is imposed depends on whether the predictive statement was "false" when it was made. The answer to this inquiry, however, does not turn on whether the prediction in fact proved to be wrong; instead, falsity is determined by examining the nature of the prediction-with the emphasis on whether the prediction suggested reliability, bespoke caution, was made in good faith, or had a sound factual or historical basis. See, e.g., Luce v. Edelstein, 802 F.2d 49, 56 (2d Cir. 1986); Eisenberg v. Gagnon, 766 F.2d 770, 775 (3d Cir.), cert. denied, 474 U.S. 946, 106 S.Ct. 342, 88 L.Ed.2d 290 (1985); Goldman v. Belden, 754 F.2d 1059, 1068-69 (2d Cir. 1985); First Virginia Bankshares v. Benson, 559 F.2d 1307, 1314 (5th Cir. 1977); Polin v. Conductron Corp., 552 F.2d 797, 804-7 (8th Cir.), cert. denied, 434 U.S. 857, 98 S.Ct. 178, 54 L.Ed.2d 129 (1977); Marx, 507 F.2d at 490; G & M, Inc. v. Newbern, 488 F.2d 742, 745-56 (9th Cir. 1978); Alfaro v. E.F. Hutton & Co., 606 F.Supp. 1100, 1104 (E.D. Penn. 1985). Because a clear body of law exists which recognizes those circumstances where liability can be imposed under the securities laws for disclosed

> predictions, the district court obviously erred in concluding that disclosed predictions are never actionable.

Id. at 203-204. (Emphasis added). In other words, just as a prediction of future events can be actionable in Florida as fraud when the speaker knows the prediction is false when made, such a representation can be actionable under the securities laws. The test is whether the projection "suggested reliability, bespoke caution, was made in good faith, or had a sound factual or historical basis." Id. Thus, PKF's assertion that its studies are per se not actionable even under a fraud theory is incorrect. However, as we have previously emphasized, the allegations before this Court do not sound in fraud. They are negligence and gross negligence claims. The fundamental distinction between these claims and claims for fraud based upon projections was articulated by the court in In re National Smelting of New Jersey, supra, one of the cases relied upon by Petitioner:

> [A]ny reliance plaintiffs placed upon Arthur Young's representations contained in its draft of the Financial Forecast would necessarily have to be tempered by the language of review itself, which clearly counseled caution. Luce, supra, at 56. It is difficult, therefore , to fairly ascribe to Arthur Young any awareness that plaintiffs would rely on their word (as opposed to their professional skill in preparing a financial forecast based on unaudited information and assumptions provided by management) in investing in the industrial revenue bonds.

772 F.Supp. at 171. (Emphasis added).

As far as the Respondents' negligence count is concerned, what was being relied upon was not PKF's "word", but rather PKF's

"professional skill" in preparing a financial forecast and market demand report. It is alleged that PKF failed to use the degree of care required in connection with this engagement, and such allegations certainly state a cause of action.

Finally, in addition to alleging that PKF failed to exercise reasonable care in preparing its studies, the counterclaim at issue here also alleges that prior to the closing PKF obtained actual knowledge of the fact that its studies were not reliable, and that PKF knew that many of the assumptions on which its studies were based did not, and in fact would not come into fruition. (A-90-91). Such allegations are clearly actionable.

For example, in Rudolph V. Arthur Anderson & Co., 800 F.2d 1040 (11th Cir. 1986), Plaintiff alleged that reports and statements prepared by Arthur Anderson were included in a private placement memorandum used to sell limited partnership investments. It further alleged that at some point after the issuance of the placement memo, Arthur Anderson became aware of a scheme whereby Delorean intended to drop the original purpose of the offering and instead divert the funds raised to other uses. In determining that the allegations against Arthur Anderson stated a cause of action for both primary and aiding and abetting liability under Rule 10(b)-5, the Eleventh Circuit concluded that:

> Although this court has not considered the issue, but see Woodward, 522 F.2d at 97 n. 28 (listing accountants as an example of groups with "special obligations" imposing duty to disclose), other courts have held that accountants "have a duty to take reasonable steps to correct misstatements they have

> discovered in previous financial statements on which they know the public is relying." IIT, An International Investment Trust v. Cornfeld, 619 F.2d 909, 927 (2d Cir. 1980) (citing with approval Fischer v. Kletz, 266 F.Supp. 180, 188 (S.D.N.Y. 1967)). This duty arises from the fact that investors are likely to rely on an accountant's work.

Id. at 1043-44. (Emphasis added). The court then held that:

> The rule that an accountant is under no duty to disclose ordinary business information, unless it shows a previous report to have been misleading or incorrect when issued, is a sensible one. It would be asking too much to expect accountants to make difficult and time-consuming judgment calls about the nature of routine facts and figures turned up after a report has been completed. The situation is quite different, however, where the issue is disclosure of actual knowledge of fraud. Standing idly by while knowing one's good name is being used to perpetrate a fraud is inherently misleading. An investor might reasonably assume that an accounting firm would not permit inclusion of an audit report it prepared in a placement memo for an offering the firm knew to be fraudulent, and that such a firm would let it be known if it discovered to be fraudulent an offering with which it was associated. It is not unreasonable to expect an accountant, who stands in a "special relationship of trust vis-a-vis the public," Gold, 399 F.Supp. at 1127, and whose "duty is to safeguard the public interest," Touche, Niven, Bailey & Smart, 37 S.E.C. 629, 670 (1957), to disclose fraud in this type of circumstance, where the accountant's information is obviously superior to that of the investor, the cost to the accountant of revealing the information minimal, and the cost to investors of the information remaining secret potentially enormous.

Id. at 1044.

It is significant to note that the plaintiffs in Rudolph did not allege that the accounting firm determined after the fact that

its own studies were misleading or fraudulent. Rather, the allegation was that the accounting firm knew or recklessly failed to learn of the issuer's intention to divert the partnership funds. Id. at 1042. Here, the allegation is that PKF knew that its own studies were misleading. And, if failing to "blow the whistle" was sufficient to impose liability upon Arthur Anderson for securities fraud in Rudolph, then PKF's failure to take any action in order to correct its own previously issued studies which it knew to be misleading, is certainly sufficient to impose liability upon PKF for gross negligence. See also Roberts v. Pete Marwick Mitchell & Co., 857 F.2d 646 (9th Cir. 1988) (investors in limited partnership stated a claim against the accounting firm for aiding and abetting fraud and violations of Rule 10(b)-5 based upon the allegation that the firm participated in partnership offering memoranda with knowledge that the same were false and misleading, and furthered a fraud by consenting to inclusion of its name).

Here, the information obtained by PKF was obviously superior to that known to the investors; the cost to PKF of revealing the information known to it or otherwise preventing the seller from continuing to use the studies was minimal; and the cost to the investors of the information remaining secret was enormous. See Rudolph, supra. Under these circumstances it is apparent that Respondents have stated a cause of action.

In sum, an accountant may be held liable for negligence when it fails to exercise the degree of care and skill that a prudent professional would exercise under the circumstances, regardless of

the nature of the accountant's task. See, e.g., Coleco Industries, Inc. v. Berman, 423 F.Supp. 275 (E.D. Penn. 1976) (refused to absolve accountants for negligence simply because the report was "unaudited" as opposed to "audited." As the court indicated in Ryan v. Kanne, 170 N.W.2d 395 (Iowa 1969):

> ...[I]t is clear to us that accountants, or any other professional persons, must perform those acts that they have agreed to do under the contract and which they claim have been done in order to make the determination set forth and presented in their report. Their liability must be dependent upon their undertaking, not their rejection of dependability. They cannot escape liability for negligence by a general statement that they disclaim its reliability.

Id. at 404. In this case, PKF was retained to prepare the studies contained in the PPM, and if they did so negligently they may be held accountable to Respondents for any damages proximately caused thereby. The fact that PKF points out that its studies were mere forecasts, as opposed to audited financial statements, is irrelevant. If it negligently prepared the forecasts, it can be held accountable for negligence just as it could be if it negligently prepared audited financial statements, unaudited financial statements, or any other type of report that it had been paid to assimilate.

CONCLUSION

For the foregoing reasons this Court should affirm the decision below and remand this case to the trial court for further proceedings.

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and accurate copy of the foregoing was delivered by mail this 14th day of June, 1990 to Allen P. Reed, Esq., Shea & Gould, 1428 Brickell Avenue, Miami, Florida 33131.

By: _____
Michael A. Hanzman