Common Law Liability of the Certified Public Accountant for Negligent Misrepresentation

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The scope of the duty owed by the accountant for negligent misrepresentation has traditionally been limited to those with whom he is in privity pursuant to the rationale described by Judge Cardozo in Ultramares v. Touche. *This article questions that rationale and suggests that social, economic and legal considerations now require accountants to be judged by the same standards applied to other professionals.*

INTRODUCTION

This article—"Common Law Liability of the Certified Public Accountant for Negligent Misrepresentation" or "*Ultramares* Revisited"—was prompted by my exposure to an appeal in a coordinated proceeding involving twenty-three plaintiffs who successfully sued Touche Ross & Co. (Touche), a national firm of certified public accountants, for negligent misrepresentation, obtaining judgments for about $26,800,000.[1] The details of the in-

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1. Swiss Bank Corp. v. Touche Ross & Co., Civ. No. 18057 (Cal. Ct. App., 4th Dist., stipulated reversal June 1980) (Coordination Proceeding Special Title, Rule 1550(b)) (commonly referred to as the *U.S. Financial* case). Following oral argu-

tricate financial machinations of U.S. Financial, a San Diego-based real estate conglomerate, and the relationship and ultimate liability of Touche were presented to a jury in a nine-month trial which included 900 exhibits, 75 witnesses and 18,000 pages of transcript. (For the interested reader, an abbreviated and generalized statement of the facts of the *U.S. Financial* case is set out in the Appendix.[2]) Although the trial, in typical southern California style, was probably more grandiose than the usual case, I believe it fair to assume that as a combined result of creative litigators, "deep pockets" and expanded theories of tort liability in our increasingly complex financial world, similar scenarios with like characters bearing different names have been, are, and will be playing to packed houses across the country.[3] Regardless of the

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ment and submission of the case for decision, counsel for all parties advised the court that the case had been settled. Terms of the settlement were not disclosed; accordingly, the court neither prepared nor filed an opinion. To the extent that views are expressed in the following pages, those views are solely my own and may not be attributed to the court nor panel which heard oral argument.

2. Although not essential to an understanding of the legal issues, these facts permit a fuller appreciation of the difficulties involved in devising a simple formula to resolve the problems which can arise in an almost infinite number of commercial situations.

3. This broad statement unsupported by independent social scientific research is reflected time and again in the footnotes which abound in the myriad of articles written on this subject. *See, e.g.*, Besser, *Privity?—An Obsolete Approach to the Liability of Accountants to Third Parties*, 7 SETON HALL L. REV. 507, 507 n.2 (1976):

> There has been a significant rise in the number of lawsuits brought against accountants in the past decade [1966-1976]. In 1966 it was reported that approximately 100 suits were in various stages of litigation. Wall St. J., Nov. 15, 1966, at 1, col. 6, at 13, col. 2. By 1973, 'more than 500 companies ha[d] litigation or claims in process involving auditors.' Hawes, *Truth in Financial Statements: An Introduction*, 28 VAND. L. REV. 1, 1 n.1 (1975). Recently *The New York Times* reported that about 300 suits were in progress against less than twelve of the largest domestic accounting firms. N.Y. Times, Nov. 23, 1975, § 3, at 14, col. 8. It has also been estimated that over two hundred claims are pending against the smaller firms. *See* Griffin, *The Beleaguered Accountants: A Defendant's Viewpoint*, 62 A.B.A. J. 759, 759 (1976).

See also Mess, *Accountants and The Common Law: Liability to Third Parties*, 52 NOTRE DAME LAW., 838 (1977): "'Professions once seemingly inviolate from litigation are no longer sacrosanct. The age old axiom that physicians bury their mistakes, while attorneys and accountants file theirs away has little relevance in modern-day America." *Id.* at 838 n.1 (citing Eizenstat & Speer, *Accountants' Professional Liability: Expanding Exposure*, 22 FED. INS. COUNS. Q. 7 (1972)). As recently as December 28, 1981, the legal newspaper, *The Los Angeles Daily Journal*, carried the news item that attorneys' fees of $1,180,000 were awarded to counsel for plaintiffs in Litowitz v. Arthur Andersen & Co. for their services in arranging a settlement fund of about $6,000,000 in a class action. One of the settling defendants was the national accounting firm of Arthur Andersen & Co., charged with making omissions in financial statements of bankrupt Frigitemp Corporation in violation of the federal securities laws. L.A. Daily J., Dec. 28, 1981, at 1, col. 5.

It should come as no surprise that the bulk of reported cases against accountants are those against the "Big Eight" who perform the audits for about 80 percent of the publicly held companies in the United States. These firms are: Peat, cause, consumer awareness or commercial greed, it is only to have been expected that when the accountant became high priest[4] willing for a fee to translate, through the added mystique of computer software, the jargon of almost incomprehensible financial transactions into neat, tabulated and word-processed form, he became targeted as the prime defendant when the publicly held corporation he audited became bankrupt.[5]

A convenient and perhaps essential starting point for any discussion of the scope of the accountant's liability is *Ultramares Corp. v. Touche*.[6] There, defendants, a firm of certified public accountants employed by Fred Stern & Co., Inc. to conduct an annual audit negligently overvalued the assets of the company. Plaintiff, who had loaned money in reliance upon the certified balance sheet supplied by Stern, successfully sued Touche. On appeal Judge Cardozo, speaking for a unanimous court, absolved the accountants by saying:

> 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

Marwick & Mitchell Co.; Arthur Andersen & Co.; Ernst & Ernst; Price Waterhouse & Co.; Haskins & Sells; Lybrand Bros.; Touche, Ross & Co.; and Arthur Young & Co. *See* Comment, *Auditors' Third Party Liability: An Ill-Considered Extension of the Law*, 46 WASH. L. REV. 675, 680 n.25 (1971). The smaller accounting firm, however, is not free from litigation for statistically there has been an increase in suits against these firms as well. Dickenson, *The C.P.A.'s Dilemma—Myths and Realities*, CAL. C.P.A. Q., Mar. 1977, at 12.

4. This perceived status of the accountant may well be due to the accountants' self-fulfilling prophecy. In discussing developments in Accounting & Auditing Standards established by the Financial Accounting Standards Board and Committees of the American Institute of Certified Public Accountants (AICPA), one speaker explained that accountants "just have to assume that the average layman cannot comprehend them [financial statements] and that, like the mysteries of ancient Egypt, you need an elite priesthood to define and interpret what appears in the financial statements." Stanger, *Developments in the Conceptual Framework for Financial Accounting and Reporting, and Their Impact Upon Legal Considerations*, 33 BUS. LAW. 2447, 2448 (1978).

5. The mysteries of finance are not, of course, reserved to non-accountants who may have both the intellectual and emotional need for accounting guidance. Even those charged with the financial planning for this country confess in rare, but probably truthful moments that "[n]one of us really understands what's going on with all these numbers . . . ." Grieder, *The Education of David Stockman*, ATL., Dec. 1981, at 38. When the Director of the Office of Management & Budget admits that figures which have passed the scrutiny of select committees and staff of the Congress are still unintelligible, the vehemence of the aggrieved creditor toward the accountant, generally the only surviving and solvent remnant of the debtor, becomes more understandable.

6. 255 N.Y. 170, 174 N.E. 441 (1931).

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.[7]

Whether due to the compelling logic of the holding,[8] the status of Cardozo,[9] concern for the fledgling profession of accountancy,[10] or a combination of each, the *Ultramares* holding remained intact for many years in every jurisdiction where the issue was raised. Only comparatively recently has there been a fresh look at the problem free from the gloss of Cardozo hyperbole with a rejection of privity as a necessary element.

This article will first briefly review accounting standards governing accountants in performing a certified audit; second, take a closer look at *Ultramares*, its progeny and those cases rejecting it; and third, inquire into the present validity of the policy considerations upon which *Ultramares* is based. It concludes by suggesting an alternative analytic approach more consistent with the development of tort law in other fields, that is, that absent defined external policy considerations, the accountant be held liable for any reasonably foreseeable harm caused by his negligence.[11]

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7. *Id.* at 179-80, 174 N.E. at 444.

8. One "probable reason" given for the "continued viability of the privity defense in the area of accountants' liability is the strength of the *practical* arguments supporting the *Ultramares* decision." Comment, *supra* note 3, at 679 (emphasis added).

9. Awe for Cardozo has been advanced by more than one commentator as the reason for the viability of *Ultramares*. *See* Shugrue, *Auditing the Auditors*, 13 TRIAL 31 (1977). Professor Seavey has not been shy in criticizing Cardozo opinions and flushing out areas where Cardozo's parade of horribles really amounts to an overstatement, probably unnecessary to his holding. *See* Seavey, *Mr. Justice Cardozo and The Law of Torts*, 52 HARV. L. REV. 372, 400 (1939).

10. Referring to the fact that in 1960 when the "Big Eight" grossed over $200 million, it has been said that "in the light of the economic maturation of the independent accounting profession, . . . dependence on . . . judicial solicitude seems ill-advised." Bradley, *Auditors Liability and the Increased Need for Accounting Uniformity*, 30 LAW & CONTEMP. PROBS. 898, 921 (1965). By 1981, gross revenues for the top eight firms had increased to well over $6 billion. Wayne, *The Year of the Accountant*, N.Y. Times, Jan. 3, 1982, § 3, at 1. *See generally* SUBCOMM. ON REPORTS, ACCOUNTING, AND MANAGEMENT OF THE SENATE COMM. ON GOVERNMENT OPERATIONS, THE ACCOUNTING ESTABLISHMENT, S. Doc. No. 34, 95th Cong., 1st Sess. (1977) [hereinafter cited as THE ACCOUNTING ESTABLISHMENT]. Interestingly, although Cardozo deferred to the legislature to create what he described as a "revolutionary change" in permitting liability of accountants without the need for privity, no state legislature has done so. No effort will be made here to answer whether the absence of state legislation reflects the extent of the problem or merely the presence of political muscle by the accounting profession.

11. As noted in the preceding footnote, the discussion which follows is restricted to judicial analysis. There is presently no state legislation limited solely to the tort liability of the accountant. Presumably, no crisis comparable to the medical malpractice crisis has arisen or been orchestrated.

STANDARDS GOVERNING THE PERFORMANCE OF AN AUDIT

Ready access to relevant information on a company's financial status is not only essential to that company's business planning, but necessary for other persons interested in the company. Whether those persons are in the private sector (current or prospective shareholders, institutional lenders or small private creditors) or in the public sector (the Internal Revenue Service), accurate financial statements reflecting the company's financial condition and results of operations at a given point in time are required. Thus, in the ordinary course of business a company must prepare financial statements. In this sense, the preparation of those statements is not the job of outside auditors. However, it is the function of those auditors to evaluate the financial statements in order to express a professional opinion on them following an audit.

For accounting purposes, "audit" is a term of art. The ultimate objective of an audit is to express an opinion on the fairness with which the financial statements "present financial position, results of operations, and changes in financial position in conformity with generally accepted accounting principles."[12] The report by the auditor is the way "he expresses his opinion or, if circumstances require, disclaims an opinion. In either case, he states whether his examination has been made *in accordance with generally accepted auditing standards* (GAAS). These standards require him to state whether, in his opinion, the financial statements are presented *in conformity with generally accepted accounting principles* (GAAP) and whether such principles have been *consistently applied in the preparation of the financial statements of the current period in relation to those of the preceding period*."[13]

The accountant's report normally forms the basis for any assertion of liability against him. Statements on Auditing Standards, promulgated by the American Institute of Certified Public Accountants (AICPA), govern the preparation of these reports as well as other aspects of the accountant's work.[14] The reporting standards provide as follows:

12. 1 American Institute of Certified Public Accountants, PROFESSIONAL STANDARDS, AU § 110.01 (1980) [hereinafter cited as AICPA].

13. *Id.* (emphasis added).

14. The AICPA standards also provide general guidelines and regulate the conduct of field work:

General Standards

1. The report shall state whether the financial statements are presented in accordance with generally accepted accounting principles.
2. The report shall state whether such principles have been consistently observed in the current period in relation to the preceding period.
3. Informative disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report.
4. The report shall either contain an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an overall opinion cannot be expressed, the reasons therefor should be stated. In all cases where an auditor's name is associated with financial statements, the report should contain a clear-cut indication of the character of the auditor's examination, if any, and the degree of responsibility he is taking.[15]

The objective of the fourth standard of reporting is to prevent misrepresentation of the degree of responsibility the auditor is assuming when his name is associated with financial statements.[16] When the accountant expresses an unqualified opinion he is saying that the financial statements fairly present financial position; GAAP, with adequate disclosure, has consistently been applied to the results of operations and changes in financial position.[17] This conclusion may be expressed only when the auditor has formed such an opinion on the basis of an examination made in accordance with GAAS. When the auditor is of the opinion that the financial statements *do not* present fairly the financial position in conformity with GAAP, an adverse opinion is required.[18]

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1. The examination is to be performed by a person or persons having adequate technical training and proficiency as an auditor.
2. In all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or auditors.
3. Due professional care is to be exercised in the performance of the examination and the preparation of the report.

Standards of Field Work

1. The work is to be adequately planned and assistants, if any, are to be properly supervised.
2. There is to be a proper study and evaluation of the existing internal control as a basis for reliance thereon and for the determination of the resultant extent of the tests to which auditing procedures are to be restricted.
3. Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under examination.

Id. AU § 150.02.

15. *Id.*

16. *Id.* AU § 509.05.

17. *Id.* AU § 509.28.

18. *Id.* AU § 509.41. When the auditor expresses an adverse opinion, he should disclose in a separate paragraph(s) of his report: (a) all the substantive reasons for his adverse opinion; and (b) the principal effects of the subject matter of the adverse opinion on financial position, results of operations and changes in financial position, if reasonably determinable. If the effects are not reasonably determinable, the report should so state. The report also should state any reservations the auditor has regarding fair presentation in conformity with generally accepted accounting principles other than those giving rise to the adverse opinion. *Id.* AU § 509.42. Many states, including California, have regulations governing the

These encompassing, self-regulatory principles, standards and procedures promulgated by the accounting profession itself were not of instant creation.[19] They were the amalgam of a number of forces.

Starting about the time *Ultramares* was decided, accelerating political, social and economic factors contributed to regulatory control. The accumulation of vast amounts of capital by commer-

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procedure and content of accountant's reports comparable to standards promulgated by AICPA. *See, e.g.*, CAL. ADMIN. CODE tit. 16, § 58.1 (1980), adopted by the State Board of Accountancy pursuant to CAL. BUS. & PROF. CODE §§ 5010, 5018 (West 1974).

19. Compliance with GAAP does not necessarily immunize the accountant from liability. In a criminal suit, United States v. Simon, 425 F.2d 796 (2d Cir. 1969), *cert. denied*, 397 U.S. 1006 (1970), the jury was properly told of the defendants' contention that they acted honestly and in good faith in accordance with GAAS and GAAP.

> Proof of compliance with generally accepted standards was "evidence which may be very persuasive but not necessarily conclusive that he acted in good faith, and that the facts as certified were not materially false or misleading." "The weight and credibility extended by you to such proof, and its persuasiveness, must depend, among other things, on how authoritative you find the precedents and the teachings relied upon by the parties to be, the extent to which they contemplate, deal with, and apply to the type of circumstances found by you to have existed here, and the weight you give the expert opinion evidence offered by the parties. That may depend on the credibility extended by you to expert witnesses, the definiteness with which they testified, the reasons given for their opinions, and all the other facts affecting credibility. . . ."

425 F.2d at 805-06 (quoting the jury instructions). The critical test, therefore, was "whether the financial statement as a whole 'fairly presented the financial condition of Continental as of September 30, 1962 and whether it accurately reported the operations for fiscal 1962.'" *Id.* at 805 (quoting the jury instructions). A similar statement appears in Herzfeld v. Laventhol, Krekstein, Horwath & Horwath, 378 F. Supp. 112, 121 (S.D.N.Y. 1974), *aff'd in part, rev'd in part*, 540 F.2d 27 (2d Cir. 1976), where the accountants were sued under section 10(b) of the Securities Exchange Act for violating rule 10(b)-5. "Much has been said by the parties about generally accepted accounting principles and the proper way for an accountant to report real estate transactions. We think this misses the point. Our inquiry is properly focused not on whether Laventhol's report satisfies esoteric accounting norms, comprehensible only to the initiate, but whether the report fairly presents the true financial position of Firestone, as of November 30, 1969, to the untutored eye of an ordinary investor." *See also* Thor Power Tool Co. v. C.I.R., 439 U.S. 522 (1979). Whatever the scope of the duty, it is now clear the accountant can no longer be sanguine as to the absence of liability because he complied with GAAP and performed his audit in accordance with GAAS. Comment, *Thor Power Tool Co. v. C.I.R. Further Erodes C.P.A.'s Defense of Observing Professional Standards*, 19 AM. BUS. L.J. 87, 96 (1981). Nor can the accountant rest comfortably, free from anxiety about the possibility of imposition of discipline under the Securities and Exchange Commission (SEC) Rule 2(e). In performing its regulatory function the SEC does not always agree with the judgments exercised by independent auditors. Chazen & Ten Eyck, *Lessons to be Learned from Rule 2(e) Proceedings*, FIN. EXECUTIVE, July 1981, at 19.

cial enterprises through increased public ownership of these companies, combined with greater governmental involvement due to dramatic economic and political failures, brought about changes in both the role and control of the accountant.[20] The use of capital from large numbers of outside investors not only altered the financial scene by requiring greater disclosure by management but, capturing the insatiable capitalistic appetite of many who had otherwise managed to escape the allure of Wall Street, contributed greatly to the stock market crash of 1929. That crash, sparking severe criticism of accounting practices by Congress, was one of the reasons for the passage of the federal securities laws in 1933 and 1934.[21] The Securities & Exchange Commission (SEC), created in 1934 to maintain and enforce compliance with the securities laws,[22] has thus far remained satisfied that investor protection is assured when the accounting profession remains essentially autonomous, setting its own accounting rules and standards subject to SEC oversight.[23]

To suggest that Congress and/or any of its watchdog commissions acted with speed in response to this crisis, however, is inaccurate. Not until 1940 did the SEC issue what now appears to have been long overdue, Accounting Series Release No. 19 in the *McKesson & Robbins* case,[24] criticizing the accountants for inaccuracies in the corporation's audited financial statements. The SEC recommended in part that the accounting profession take physical inventories and verify accounts and notes receivable in an audit. The auditing standards referred to earlier[25] were adopted by AICPA in response to these recommendations.

More recently, financial upheaval in the form of "Equity Fund-

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20. *See generally* J. Carey, The Rise of the Accounting Profession (1969).

21. Securities Act of 1933, ch. 38, 48 Stat. 74 (1933); Securities Exchange Act of 1934, ch. 404, 48 Stat. 881 (1934); *see* Gruenbaum and Steinberg, *Accountants' Liability and Responsibility: Securities, Criminal and Common Law*, 13 Loy. L.A.L. Rev. 247 (1980).

22. Accountants may be liable under the Securities Act of 1933 §§ 11, 12, 15 U.S.C. §§ 77k, 77*l* (1976), and the Securities Exchange Act of 1934 § 18, 15 U.S.C. § 78i (1976). Section 11 imposes liability for material misstatements or omissions in a registration statement filed with the SEC which has become effective. *See* Escott v. Bar Chris Const. Corp., 283 F. Supp. 643 (S.D.N.Y. 1968). Section 12 imposes liability on those persons who offer to sell a security by means of a prospectus or oral communications which includes an untrue statement of material fact or omits to state a material fact. Section 18 imposes liability on any person who makes or causes to be made any materially false or misleading statement in any application, report or document filed with the SEC under the Exchange Act. *See also* SEC Rule 2(e) permitting discipline and sanctions for errant accountants.

23. J. Abraham, The Public Accounting Profession 131 (1978).

24. *In re* McKesson & Robbins, Inc., (1940), *reprinted in* 5 Fed. Sec. L. Rep. (CCH) ¶ 72,020 (1977).

25. *See supra* note 14 and accompanying text.

ing"[26] and political shock in the form of Watergate have prompted further self-regulatory and legislative action—the former resulting in Auditing Standards 16 and 17;[27] the latter in the Foreign Corrupt Practices Act of 1977 (FCPA)[28]—in an attempt to regulate unethical and/or illegal payments by United States companies, both domestic and abroad. The FCPA imposes certain accounting controls and prohibits payments of bribes by public and non-public companies with both civil and criminal penalties for violations. The effectiveness of these controls is certainly questionable, reflective perhaps only of governmental naivete, for arguably implicit in accounting is the ability of the cost accountant to rationally allocate these dishonest payments to a lawful category.[29] Because of this consideration and others,[30] it is uncertain whether Congress will be content to continue to permit accountancy self-regulation. In any event, regardless of the extent and source of further regulation, the accounting profession will doubtless be affected by the results of individual cases litigated on a common law basis in state courts throughout the country.[31]

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26. "Equity Funding" refers to the activities of Equity Funding Corporation of America and its subsidiaries which became the target of an SEC investigation, criminal charges, and a variety of civil suits during the mid-'70's. It was alleged the corporation engaged in various illegal and fraudulent practices designed to artificially inflate the market value of the corporation's securities, and that the corporate accountants aided in concealing these facts. *See generally In re* Equity Funding Corp. of Am. Sec. Litigation, 416 F. Supp. 161 (C.D. Cal. 1976).

27. AICPA, *supra* note 12, AU § 327 (Auditing Standard 16: The Independent Auditor's Responsibility for the Detection of Errors or Irregularities); *id.* AU § 328 (Auditing Standard 17: Illegal Acts of Clients). The enactment of these standards was in response to the reaction that developed after the Watergate investigations disclosed extensive evidence of illegal payments and other illegal corporate acts. Chazen, *Responsibilities of Auditors*, in PROCEEDINGS OF THE FIRST ANNUAL INSTITUTE ON SECURITIES LAWS & REGULATIONS 107-08 (1977); *see also* Kapp, *Some Problems of a Legal Compliance Audit*, 33 BUS. LAW. 2467 (1978).

28. Foreign Corrupt Practices Act, Pub. L. No. 95-213, § 102, 91 Stat. 1494, 1494-95(1977) (amending § 13(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78m(b) (Supp. 1980)).

29. *See* Hetherington, *Reflections on Corporate Governance and Shareholders' Rights*, 8 HOFSTRA L. REV. 183, 232 n.157 (1979).

30. Problems inherent in self-regulation include the lack of a truly adversary proceeding to generate conflicting viewpoints on the societal interests involved and the possible appearances of impropriety when the professional is judged only by his peers.

31. The effect of federal legislation upon the practice of accountancy and the criminal and civil liability of the accountant under those laws is again outside the scope of this article. The brief discussion of federal law is only to sensitize the reader to considerations which may impact the resolution by state courts on the policy question of duty and ultimate liability of the accountant for the breach of that duty. Moreover, given the United States Supreme Court's current antipathy

The impact of *Ultramares* on the development of the common law of accountants' liability for negligent misrepresentation cannot be overestimated.[32] Appearing somewhat of an aberration even when it was decided by the highest New York state court during its golden years,[33] *Ultramares* has nevertheless withstood the passage of time with remarkable vigor.

In *MacPherson v. Buick Motor Co.*,[34] decided fifteen years before *Ultramares*, Cardozo eliminated the requirement of privity to permit the recovery of damages from a manufacturer where the manufacturer's negligence caused personal injuries to third persons:

> If the nature of a thing is such that it is reasonably certain to place life and limb in peril when negligently made, it is then a thing of danger. . . . We have put aside the notion that the duty to safeguard life and limb, when the consequences of negligence may be foreseen, grows out of contract and nothing else. We have put the source of the obligation where it ought to be. We have put its source in the law.[35]

It is thus, according to Cardozo, the foresight of the consequences and not the contractual relationship which creates the duty.[36]

Within a half-dozen years the same New York court in *Glanzer v. Shepard*[37] had occasion to consider the imposition of liability to a third person not in privity where only intangible economic interests were involved. There, plaintiffs purchased bags of beans from a company, payment for which was to be made in accordance with the weight sheets certified by defendants, public weigh-

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to private enforcement of the federal securities laws where "mere" negligence is involved (*see* Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976)), state courts will likely constitute the only available forum for a vast number of injured parties in the foreseeable future.

32. The policy considerations expressed in *Ultramares* are, of course, not restricted to the accountancy profession. The case itself or its rationale has been used as the underpinning to limit liability for lawyers, abstracters, engineers, and architects. *See, e.g.*, Roady, *Professional Liability of Abstracters*, 12 VAND. L. REV. 783 (1959); Allen, *Liabilities of Architects and Engineers to the Third Parties*, 22 ARK. L. REV. 454 (1968); Reagan & Grossman, *Liability of Third Parties for Economic Injury: Privity as a Useful Animal, or a Blind Imitation of the Past*, 12 SW. U. L. REV. 87 (1981).

33. *See* Mallis v. Bankers Trust Co., 615 F.2d 68, 81 (2d Cir. 1980).

34. 217 N.Y. 382, 111 N.E. 1050 (1916).

35. *Id.* at 385, 111 N.E. at 1053.

36. In Cardozo's view, *MacPherson* was consistent with the settled law of New York. The majority made clear they had no desire to return to the bastion of privity established in Winterbottom v. Wright, 10 M & W 109, 152 Eng. Rep. 402 (1842). 217 N.Y. at 386, 111 N.E. at 1054. It is interesting to note, however, that although *Winterbottom*'s rationale was rejected (i.e., the alleged absurdity of having an unlimited class of plaintiffs), this same rationale, without reference to precedent, was used by Cardozo in *Ultramares* to deny recovery. 255 N.Y. at 179-80, 174 N.E. at 444.

37. 233 N.Y. 236, 135 N.E. 275 (1922).

ers. When plaintiffs discovered a shortfall in the weight of the beans, they sued for the amount overpaid. In affirming the judgment in plaintiffs' favor, Cardozo again explained "the law imposes a duty toward buyer as well as seller. The plaintiffs' use of the certificates was not an indirect or collateral consequence of the action of the weighers. It was a consequence which, to the weighers' knowledge, was the end and aim of the transaction."[38] The *Glanzer* court attempted to minimize the effect of its decision by referring first to *MacPherson* before going on to say "[t]here is nothing new here in principle. If there is a novelty, it is the instance only. One who follows a common calling may come under a duty to another whom he serves, though a third may give the order or make the payment."[39] Illustrations of imposition of liability where the bill was paid by a third person include the negligent doctor to his patient, the bailee careless in the receipt of goods and the negligence by a searcher of title. "Constantly the bounds of duty are enlarged by knowledge of a prospective use."[40] The obligation of defendants may not be stated merely in terms of contract, "but of duty."[41]

With this precedential foundation it might readily have been anticipated that only nine years later *Ultramares* would have been decided in a similar fashion. However, Cardozo's anxiety over the implications of creating liability in an indeterminate sum for an indeterminate class of potential plaintiffs was apparently sufficient to deter him from extending liability on negligence grounds, particularly where plaintiffs had redress for deceit.[42] In distinguishing *Glanzer*, he referred to the weigher's certificate which was the "end and aim of the transaction,"[43] contrasting that with potential liability for those only incidentally or remotely involved in the accountant-client relationship. Thus, even with the recognition that "[t]he assault upon the citadel of privity is pro-

38. *Id.* at 238-39, 135 N.E. at 275.
39. *Id.* at 239, 135 N.E. at 276 (citations omitted).
40. *Id.* at 240, 135 N.E. at 276.
41. *Id.* at 241, 135 N.E. at 277. Apparently not all courts were overwhelmed by the wisdom of Cardozo. The appellate department of the Superior Court for Los Angeles County rejected an appeal from the municipal court by a plaintiff for his claim of $382. The court held a contractor could not recover against a civil engineer who negligently prepared grading sheets which were known by him to be used and relied upon by plaintiff. *See* Bilich v. Barnett, 103 Cal. App. 2d Supp. 921, 229 P.2d 492 (1951).
42. 255 N.Y. at 179-80, 174 N.E. at 444.
43. *Id.* at 182, 174 N.E. at 445.

ceeding in these days apace,"[44] the *Ultramares* court in denying recovery jumped from what they perceived to be the economically devastating "slippery slope" of *Glanzer* and retreated to the safer ground of privity.[45]

In light of this background and the development of tort law in other areas, it would also have been reasonable to assume that in the half-century since *Ultramares*, its privity doctrine would have received a decent but final interment. How could it remain alive in a legal environment which gave rise to *Biakanja v. Irving*,[46] *Greenman v. Yuba Power Products, Inc.*[47] and *Codling v. Paglia*?[48]

In *Biakanja*, the California Supreme Court virtually abandoned privity in holding a notary public who negligently failed to direct proper attestation of a will could be liable in tort to an intended beneficiary who suffered damage because of this oversight. Concluding the will was the "end and aim of the transaction,"[49] the *Biakanja* court explained:

> The determination whether in a specific case the defendant will be held liable to a third person not in privity is a matter of policy and involves the balancing of various factors, among which are the extent to which the transaction was intended to affect the plaintiff, the foreseeability of harm to him, the degree of certainty that the plaintiff suffered injury, the closeness of the connection between the defendant's conduct and the injury suffered, the moral blame attached to the defendant's conduct, and the policy of preventing future harm.[50]

These factors, a synthesis from the work of both Prosser and Harper and James,[51] have been extensively relied on by Califor-

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44. *Id.* at 180, 174 N.E. at 445.

45. The strength of Cardozo's opinion in *Ultramares* is certainly not enhanced by his characterization of plaintiffs as only incidental to the transaction. The audit of Stern's books not only was obviously intended for use by creditors, but it was known by Touche that it would be used for that purpose. The fact that 32 copies of the certified balance sheet were involved can hardly be said to be a mere coincidence or indeterminate in size. Notwithstanding what appears to be the obvious and recognized flaws in *Ultramares*, it remains comfortably ensconced as a legal milestone. *See* Besser, *supra* note 3, at 515 n.33.

46. 49 Cal. 2d 647, 320 P.2d 16 (1958).

47. 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1963).

48. 32 N.Y.2d 330, 298 N.E.2d 622, 345 N.Y.S.2d 461 (1973).

49. The *Biakanja* court relied on Glanzer v. Shepard, 233 N.Y. 236, 135 N.E. 275 (1922), in reaching this conclusion. 49 Cal. 2d at 650, 320 P.2d at 19; *see supra* note 38 and accompanying text.

50. 49 Cal. 2d at 650, 320 P.2d at 19. The criteria used in *Biakanja* have since been applied to hold other professionals not in privity liable for negligence. *See, e.g.*, Lucas v. Hamm, 56 Cal. 2d 583, 364 P.2d 685, 15 Cal. Rptr. 821 (1961) (lawyers); Huber, Hunt & Nichols, Inc. v. Moore, 67 Cal. App. 3d 278, 136 Cal. Rptr. 603 (1977) (architects); M. Miller Co. v. Davis & Morse, 198 Cal. App. 2d 305, 18 Cal. Rptr. 13 (1961) (engineers).

51. The *Biakanja* court cited sections 36, 88 and 107 of W. PROSSER, HANDBOOK OF THE LAW OF TORTS (2d ed. 1955) and section 18.6 of 2 F. HARPER & F. JAMES, TORTS (1956). 49 Cal. 2d at 650, 320 P.2d at 19.

nia courts[52] and courts of other jurisdictions[53] as a generally applicable test for determining whether the defendant owed a duty to the plaintiff.[54]

Greenman v. Yuba Power Products, Inc. also discarded privity in applying the concept of strict liability in tort to hold a manufacturer liable to third persons "when an article he places on the market, knowing that it is to be used without inspection for defects, proves to have a defect that causes injury to a human being."[55] The *Greenman* rationale assumed there was no longer the need to insulate a fledgling class of manufacturers when they could readily spread the cost of the increased price of the product amongst the consuming public.[56] In *Codling v. Paglia*, the New York high court joined California and other jurisdictions in holding a manufacturer of a defective product could be liable in tort to any person injured or damaged if the defect was a substantial factor in bringing about the injury.[57] Thus, even in the state of its origin, privity was discarded as a technique to limit liability.

Nonetheless, old doctrines die hard. *Ultramares* was referred to in a recent Georgia case[58] as stating the general rule of accountants' liability. "[I]n the absence of intentional misrepresentation or fraud, an accountant is not liable for negligence to a third party who is not in privity with the accountant."[59] Although acknowledging that *Ultramares* has been under attack, the Georgia court saw no reason to depart from its rationale.[60] Moreover, recent cases from a variety of jurisdictions indicate that *MacNerland* is not alone in its continued reliance on *Ultramares*.[61]

52. *See, e.g.*, J'Aire Corp. v. Gregory, 24 Cal. 3d 799, 804, 598 P.2d 60, 63, 157 Cal. Rptr. 407, 410 (1979); Tarasoff v. Regents of Univ. of California, 17 Cal. 3d 425, 434, 551 P.2d 334, 342, 131 Cal. Rptr. 14, 22 (1976); Connor v. Great Western Sav. & Loan Ass'n, 69 Cal. 2d 850, 865, 447 P.2d 609, 617, 73 Cal. Rptr. 369, 377 (1968).

53. *See, e.g.*, Howarth v. Pfeifer, 443 P.2d 39, 42 (Alaska 1968); Fickett v. Superior Court of Pima County, 27 Ariz. App. 793, 795, 558 P.2d 988, 990 (1976); A.R. Moyer, Inc. v. Graham, 285 So. 2d 397, 401 (Fla. 1973); Westerhold v. Carroll, 419 S.W.2d 73, 81 (Mo. 1967); Benco Plastics, Inc. v. Westinghouse Elec. Corp., 387 F. Supp. 772, 786 (E.D. Tenn. 1974) (applying Tennessee law).

54. For a critique of the practical relevance of the *Biakanja* factors, see *infra* text accompanying notes 110-11.

55. 59 Cal. 2d at 62, 377 P.2d at 900, 27 Cal. Rptr. at 700.

56. *See supra* note 10 and accompanying text.

57. 32 N.Y.2d at 342, 298 N.E.2d at 628, 345 N.Y.S. at 469.

58. MacNerland v. Barnes, 129 Ga. App. 367, 119 S.E.2d 564 (1973).

59. *Id.* at 370, 199 S.E.2d at 566.

60. *Id.* at 371.

61. *See, e.g.*, Stephens Indus., Inc. v. Haskins & Sells, 438 F.2d 357 (10th Cir.

The fallout of *Ultramares* has not been limited to state courts. In *Ernst & Ernst v. Hochfelder*,[62] the United States Supreme Court held that the negligence of an accounting firm was not sufficient to give rise to a cause of action under section 10(b) of the Securities Exchange Act of 1934[63] and rule 10b-5. There the plaintiffs, customers of a brokerage firm, sued the traders' accountants claiming the accountants had negligently failed to employ appropriate auditing procedures to uncover practices of the client concealing fraud. The Supreme Court held that in the absence of any allegation of intention to deceive, manipulate, or defraud, no private cause of action existed under the 1934 Act or the rule. Unwilling to extend the scope of the statute to negligent conduct, the Court cited *Blue Chip Stamps v. Manor Drug Stores*[64] where it had relied upon *Ultramares* in observing that

> [w]hile much of the development of the law of deceit has been the elimination of artificial barriers to recovery on just claims, we are not the first court to express concern that the inexorable broadening of the class of plaintiff who may sue in this area of the law will ultimately result in more harm than good.[65]

Understandably, *Hochfelder* was received in certain quarters with praise and sighs of relief because now the honest accountant was insulated from civil liability. Injured third parties would not only have to prove the audited financial statements contained a material misrepresentation, but also that the action taken by the public accountant with respect to those financial statements demonstrated a wilful intent to "deceive" and "manipulate" the ultimate users of those statements.[66]

1971); Investment Corp. of Florida v. Buchman, 208 So. 2d 291 (Fla. Ct. App. 1968); Investors Tax Sheltered Real Estate, Ltd. Etc. v. Laventhold, Krekstein, Horwath & Horwath, 370 So. 2d 815, 817 (Fla. Ct. App. 1979); *see also* Koch Industries, Inc. v. Vosko, 494 F.2d 713 (10th Cir. 1974) (applying Kansas law). Surprisingly, *Koch* cites Hedley Byrne & Co., Ltd. v. Heller & Partners, Ltd., 1964 A.C. 465, 1963 All E.R. 575, with approval. *Hedley Byrne*, however, decided the existence of a contract was unnecessary for liability to third persons where the tortfeasor could reasonably foresee reliance on his conduct. The decision was based upon the comments of Lord Denning in his dissent in Candler v. Crane, Christmas & Co., [1951] 2 K.B. 164, [1951] 1 All E.R. 426. These decisions and the later case of Haig v. Bamford, [1976] 3 W.W.R. 331, have been the subjects of considerable legal writing in Canada. *See, e.g.*, Case Comment, *Haig v. Bamford*, 15 OSGOODE HALL L.J. 474 (1977); Case Comment *Haig v. Bamford*, 42 SASK. L. REV. 147 (1977).

62. 425 U.S. 185 (1976).

63. 15 U.S.C. § 78(j)(b) (1976).

64. 421 U.S. 723 (1975).

65. *Id.* at 747-48, *cited in* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 214 n.33 (1976).

66. *See* Comment, *The Changing Legal Environment of Public Accounting: Lower Court Applications of the Hochfelder Decision*, 15 AM. BUS. L.J. 394 (1978). The *Hochfelder* opinion expressly left open the question of whether "*reckless* behavior is sufficient for civil liability under § 10(b) and Rule 10b-5." 425 U.S. at 193 n.12 (emphasis added). Federal circuit courts subsequently considering the issue have concluded that proof of recklessness will establish liability. *See, e.g.*, G.A.

The resiliency of *Ultramares* in certain state courts and its effect upon the United States Supreme Court in *Hochfelder* should not be construed, however, as reflecting its invincibility. One line of cases eschews the rigidity of *Ultramares*.[67] The inroads, however, have generally been of a limited nature, lagging far behind the development of tort law in other areas.

Section 552 of the *Restatement (Second) of Torts* rejects *Ultramares* to the extent that privity is the sole definitional criterion of duty. Nevertheless, the drafters felt comfortable traveling only so far as the path was illuminated by the *Glanzer* principle of "knowing reliance."[68] And although rejecting privity, the explanation of the *Restatement*'s reasoning is more than reminiscent of Cardozo's "slippery slope" prose in *Ultramares*:[69]

> When the harm that is caused is only pecuniary loss, the courts have found it necessary to adopt a more restricted rule of liability, because of the extent to which misinformation may be, and may be expected to be, circulated, and the magnitude of the losses which may follow from reliance upon it.[70]

Where information is negligently supplied, the party supplying it has liability where he fails to exercise reasonable care or competence in obtaining or communicating the information, except the liability is limited to loss suffered

> (a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and (b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.[71]

Reasonable foreseeability, the hallmark of the negligence determination in other areas of tort law,[72] is thus rejected as a standard for determining the accountant's liability for negligent misrepresentation.

Courts taking issue with *Ultramares*, although sometimes speaking in broader terms, have generally relied on the *Restate-*

Thompson & Co., Inc. v. Partridge, 636 F.2d 945, 961 (5th Cir. 1981); Nelson v. Serwold, 576 F.2d 1332, 1337 (9th Cir.), *cert. denied*, 439 U.S. 970 (1978); Rolf v. Blyth, Eastman Dillon & Co., Inc., 570 F.2d 38, 44 (2d Cir.), *cert. denied*, 439 U.S. 1039 (1978); Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1045 (7th Cir.), *cert. denied*, 434 U.S. 875 (1977).

67. *See generally* Annot., 46 A.L.R. 3D 979 (1972).

68. *See supra* text accompanying notes 37-41.

69. *See supra* text accompanying note 45.

70. RESTATEMENT (SECOND) OF TORTS § 552 comment a (1977).

71. *Id.* § 552.

72. *See id.* §§ 284, 289, 291; Dillon v. Legg, 68 Cal. 2d 728, 739, 441 P.2d 912, 919-20, 69 Cal. Rptr. 72, 79-80 (1968).

ment standard in assessing the extent of the accountant's liability. Recovery is limited to those situations in which the party seeking recovery is "actually foreseen as a member of a limited class of persons contemplated"[73] and one "for whose benefit and guidance the accountant *knows* the information is intended."[74] Courts using this analysis and finding liability focus on whether the accountant knew the third party would rely upon the accounting statement.[75] It is almost as if the slightest departure from *Ultramares* requires an apologia in order to prevent the irreparable economic harm which will result in deviating from the holding.

A classic example of this phenomenon is provided by *Rusch Factors, Inc. v. Levin*,[76] in which the federal district court expressed considerable doubt about the wisdom of *Ultramares*:

> Why should an innocent party be forced to carry the weighty burden of an accountant's professional malpractice? 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 on to its customers, who can in turn pass the costs on to the entire consuming public? Finally, wouldn't a rule of foreseeability elevate the cautionary techniques of the accounting profession?[77]

Rusch Factors, however, sidestepped the broad policy inquiries it posed and relied upon *Glanzer* under circumstances where the accountant was aware the plaintiff would be relying on the financial statement. The test imposed was whether the third party was "an actually foreseen member of a limited class."[78] In effect, in applying the *Glanzer* principle, the court followed the *Restatement*.

A similar approach was utilized in *Shatterproof Glass Corp. v. James*[79] in which the court discussed a liability standard based on reasonable foreseeability.[80] Although holding that "an accountant may be held liable to third parties who rely upon financial

73. Ryan v. Kanne, 170 N.W.2d 395, 402 (Iowa 1969).

74. *Id.* at 403 (emphasis in original); *see also* Larsen v. United Fed. Sav. & Loan Ass'n, 300 N.W.2d 281, 286 (Iowa 1981).

75. Larsen v. United Fed. Sav. & Loan Ass'n, 300 N.W.2d at 286; Rhode Island Hosp. Trust Nat. Bank v. Swartz, Bresenoff, Yavner & Jacobs, 455 F.2d 847 (4th Cir. 1971); Coleco Industries, Inc. v. Berman, 423 F. Supp. 275, 309-10 (E.D. Pa. 1976); Milliner v. Elmer Fox & Co., 529 P.2d 806, 808 (Utah 1974); Merit Ins. Co. v. Colao, 603 F.2d 654, 659 (7th Cir. 1979); Mallis v. Bankers Trust Co., 615 F.2d 68, 80 (2d Cir. 1980); White v. Guarente, 43 N.Y.2d 356, 361, 372 N.E.2d 315, 318, 401 N.Y.S.2d 474, 477 (1977).

76. 284 F. Supp. 85 (D. R.I. 1968).

77. *Id.* at 90-91. One commentator has provided a different perspective of the *Rusch Factors* court's questions. That author views passing on the increased cost as disastrous not only because the number of accountants will be reduced but because of the damage to the users and suppliers of capital. Comment, *supra* note 3, at 707.

78. 284 F. Supp. at 91.

79. 466 S.W.2d 872 (Tex. Civ. App. 1971).

80. *Id.* at 879.

statements, audits, etc. prepared by the accountant in cases where the latter fails to exercise ordinary care in the preparation of such statements and audits, and the third party because of such reliance suffers financial loss or damage,"[81] the court adopted the *Restatement* position in restricting the class of third parties who could sue to those persons whom the accountant knew were to rely on the certification of financial statements.[82]

The only case which moves beyond this carefully circumscribed liability is *AlumaCraft Manufacturing Co. v. Elmer Fox & Co.*[83] There the court was more expansive in attempting to define those circumstances under which an accounting firm could be liable to a third party not in privity. Although the complaint alleged the accountant knew the audit was to be used and relied upon by the plaintiff in order to set the price for shares of stock to be paid by plaintiff, and after recognizing the *Restatement*'s rejection of privity and its rejection in other cases,[84] the court held liability could be imposed by balancing the factors referred to in *Biakanja v. Irving*.[85] Except for this modest extension in a factual setting where it was unnecessary to the holding, my research has not located a reported case which allows recovery against a negligent accountant when the plaintiff was only one of a foreseeable class of persons.

ULTRAMARES: ITS TIME HAS PASSED

Why the development of the common law of accountant's liability has proceeded so cautiously, in what is almost universally perceived to be an activist judicial world, is inexplicable. Whatever the reason, the decisional line continues to hover between *Ultramares* and the *Restatement*. Clearly, the failure to move this line forward cannot rest on the difference between economic injury and physical injury. This distinction has long been blurred,[86]

81. *Id.* at 880.
82. *Id.*
83. 493 S.W.2d 378 (Mo. Ct. App. 1973).
84. In addition to the cases cited herein, the court also cited Rhode Island Hosp. Trust Nat. Bank v. Swartz, Bresenoff, Yavner & Jacobs, 455 F.2d 847 (4th Cir. 1971).
85. *See supra* notes 49-54 and accompanying text.
86. *See, e.g.*, Biakanja v. Irving, 49 Cal. 2d 647, 320 P.2d 16 (1958); Lucas v. Hamm, 56 Cal. 2d 583, 364 P.2d 685, 15 Cal. Rptr. 821 (1961). The basic principle of negligence liability in California is set out in CAL. CIV. CODE § 1714 (West 1973), which provides that every person is responsible for injuries caused by his or her

and properly so, particularly where the negligently prepared accountant's certificate has been described as an instrument "for inflicting pecuniary loss more potent than the chisel or the crowbar."[87]

Reluctance to impose liability can also no longer be attributed to the status of the accounting profession. There is no empirical data to suggest the accounting profession has withered as a result of increased liability. To the contrary, accountancy as a business seems to have flourished. The fees charged by firms have risen commensurate with the accountants' increased sophistication, and the complexity and risk associated with their endeavors.[88]

As to the function of the audit itself there has indeed been a considerable change since 1931 in the relationship between accounting firms and third persons. At an earlier time the primary responsibility of an auditor was to the owner of a business to report on the operation of that business and to detect fraud and embezzlement by the company's employees. However, as businesses needed capital beyond what the owners could supply, auditors were called upon to provide the lending and investing public with independent opinions on how fairly financial statements had been made. Likewise, the statutes administered by the Securities and Exchange Commission reflect the belief that dependable financial information is an essential prerequisite for informed investment decisions. Today, the audit of public companies is largely for the benefit of third party users.[89] The responsibility of the public accountant

> is not only to the client who pays his fee, but also to investors, creditors and others who may rely on the financial statements which he certifies. . . . The public accountant must report fairly on the facts as he finds them whether favorable or unfavorable to his client. His duty is to safeguard the public interest, not that of his client.[90]

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lack of ordinary care. That section and the cases interpreting it do not distinguish between economic loss and physical injuries. Any suggestion to the contrary was officially put to rest in J'Aire Corp. v. Gregory, 24 Cal. 3d 799, 806, 598 P.2d 60, 64, 157 Cal. Rptr. 407, 411 (1979).

87. United States v. Benjamin, 328 F.2d 854, 863 (2d Cir.), *cert. denied sub. nom.*, Howard v. United States, 377 U.S. 953 (1964).

88. "The accounting profession today needs little sympathy and should be treated as any other business. Price, Waterhouse & Co., for example, earned gross income in the United States of over $200 million in each of the five years [preceding 1979]. Its worldwide revenue grew from nearly $400 million in 1975 to $635 million in 1979." Comment, *Accountant's Liability for Negligence: A Contemporary Approach for a Modern Profession*, 48 FORDHAM L. REV. 401, 413 n.75 (1980). In fiscal 1981, three accounting firms in the "Big Eight" earned fees in excess of $900 million. Wayne, *supra* note 10.

89. *See generally* Wyatt, *Auditor's Responsibilities*, 12 ST. LOUIS U.L.J. 331 (1968).

90. Fischer v. Kletz, 266 F. Supp. 180, 184 (S.D.N.Y. 1967) (quoting In the Matter of Touche, etc., 37 S.E.C. 629, 670-71 (1957)).

The accounting profession itself acknowledges its public responsibility:

> The ethical code of the American Institute emphasizes the profession's responsibility to the public, a responsibility that has grown as the number of investors has grown, as the relationship between corporate managers and stockholders has become more impersonal, and as government increasingly relies on accounting information.[91]

If the limitation of the accountant's liability is not based upon the status of the profession, the function of the audit or the difference between economic loss and physical injuries, the reasons for the rule must lie elsewhere.

The *Restatement*, like *Ultramares*, concludes "when there is no intent to deceive but only good faith coupled with negligence, the fault of the maker of the misrepresentation is sufficiently less to justify a narrower responsibility for its consequences."[92] Its rationale appears to rest on the reasonable expectations of the user of the information. Because every user expects the information to have been compiled honestly, he should have the right to sue for fraud.[93] But because any user cannot reasonably expect the information to satisfy the terms of the obligations between the accountant and his client unless that obligation were known to the user, the user does not have the right to sue for negligence. The *Restatement* in explaining its rule says

> [b]y limiting the liability for negligence of a supplier of information to be used in commercial transactions to cases in which he manifests an intent to supply the information for the sort of use in which the plaintiff's loss occurs, the law promotes the important social policy of encouraging the flow of commercial information upon which the operation of the economy rests. The limitation applies, however, only in the case of information supplied in good faith, for no interest of society is served by promoting the flow of information not genuinely believed by its maker to be true.[94]

The cogency of this delphic reasoning may be apparent to some. Why, however, the limitation of liability will promote "the important social policy of encouraging the flow of commercial information upon which the operation of the economy rests" may not be

91. AICPA, PROFESSIONAL STANDARDS: CODE OF PROFESSIONAL ETHICS, ET § 51.04 (1982); *see also* Fiflis, *Current Problems of Accountants' Responsibilities to Third Persons*, 28 VAND. L. REV. 31, 106 (1975); WINDAL & CORLEY, THE ACCOUNTING PROFESSIONAL: ETHICS, RESPONSIBILITY AND LIABILITY 27 (1980). *But see* THE ACCOUNTING ESTABLISHMENT, *supra* note 10, at 4.

92. RESTATEMENT (SECOND) OF TORTS § 552 comment a (1977).

93. Honesty is described as requiring only "that the maker of a representation speak in good faith and without consciousness of a lack of any basis for belief in the truth or accuracy of what he says." *Id.*

94. *Id.*

clear to others. Following the *Restatement*, recovery against the accountant rests solely upon chance considerations. Where *A* negotiates with *X* bank for $50,000 credit and the bank requires an audit by independent public accountants, the accountants will be liable only to *X* bank for a negligent misrepresentation. If fortuitously, *A* had decided to go to *Y* bank for credit, the accounting firm would not be liable.[95] The placing of liability on the fortuitousness of whether the name of the bank is disclosed or whether a class of lending institutions were known to the accounting firm may be a comfortable line to be drawn by those preparing the *Restatement*, but it does not appear to rest upon sound analytical considerations. If the purpose of imposing liability is to increase the flow of *accurate* information this hardly turns on the state of mind of the accountant. Whether moral blame attaches to negligent acts is also immaterial. The concept of negligence presumes that a mistake could have been prevented through the use of reasonable care. The incentive to convey accurate information in commerce and prevent mistakes should not be diminished by the good faith of the accountant nor by the scope of his initial conversation with his client. Insulating the accountant from liability on the basis of chance considerations with the likelihood of additional inaccurate information being disseminated should not serve as the underpinning for a rule of liability.

The holding in *Ultramares* also rests on the assumption that dire economic consequences will ensue if accounting firms bear the loss sustained by investors or creditors when the accounting data is negligently prepared. This alleged horrible, taken from a parade of horribles, is a scene to which courts have given short shrift in other areas.[96] Current literature contains no reasons nor do any come to mind to support singling out the accounting profession for this type of preferential treatment.

Arguably, the limitation of accountants' liability should rest on the fact that societal interests are better served by placing the risk of loss for negligently prepared financial statements on those persons who have either bargained for the risk or who are better equipped to sustain that risk.[97] This argument is based on the reasoning that inherent in the risk-taking of the stock market or

95. *See id.* comment h, illustration 5.

96. In Lucas v. Hamm, 56 Cal. 2d 583, 364 P.2d 685, 15 Cal. Rptr. 821 (1961), holding a lawyer could be liable to a third party not in privity, the court explained that in some situations liability could be a large and unpredictable amount. "We are of the view that the extension of his liability to beneficiaries injured by a negligently drawn will does not place an undue burden on the profession, particularly when we take into consideration that a contrary conclusion would cause the innocent beneficiary to bear the loss." *Id.* at 589, 364 P.2d 688, 15 Cal. Rptr. at 824.

97. This was one of appellant's arguments in *U.S. Financial* (*see infra* Appen-

in extending credit is the real possibility that financial documents of the company involved may be inaccurate because of the accountant's good faith error. But this rationale is inconsistent with general social policy considerations suggesting that risk of loss should be imposed on the party best able to prevent its occurrence.[98] Moreover, not all lenders and investors are of an institutional specie, capable financially and in terms of expertise to guard against the accountant's negligence. Nevertheless, few would argue that the small plunger in the stock market should be permitted recovery, but on identical facts, the institutional investor could be denied that right. A rule of liability should not fluctuate depending upon the characterization of the plaintiff and the frequency, size or type of his investment. These considerations are better left to the broader concern of whether contributory or comparative negligence should bar or limit a plaintiff's recovery.

The last remaining reason supporting *Ultramares* involves the alleged difficulties which can arise when there is delay in bringing suit. The phrase "indeterminate time"[99] connotes an indefinite and never-ending period within which an action may be brought. This connotation infers prejudice to the defendant-accountant because of lapse of time. But the unfairness associated with time and the rules pertaining to the accrual of causes of action until discovery of the negligent act or the sustaining of damages are not peculiar to actions brought against accountants. Where these arguments were made against lawyers or doctors, they have either been rejected[100] or corrected by legislation.[101]

THE FORESEEABLE HARM STANDARD APPLIED TO ACCOUNTANT LIABILITY

Assuming merit in the rejection of the reasons supporting *Ultramares*, what tort analysis for determining the liability of the

dix). The thoughtful literature on this subject does not suggest this as a valid reason to support a limitation of liability.

98. Escola v. Coca Cola Bottling Co., 24 Cal. 2d 453, 462, 150 P.2d 436, 440-41 (1944) (Traynor, J., concurring); A & M Produce Co. v. FMC Corp., 135 Cal. App. 3d 473, 493, 186 Cal. Rptr. 114, 126 (1982).

99. Ultramares Corp. v. Touche, 255 N.Y. 170, 171-80, 174 N.E. 441, 444 (1931); *see supra* text accompanying note 7.

100. *See, e.g.*, Budd v. Nixen, 6 Cal. 3d 195, 201, 491 P.2d 433, 436-37, 98 Cal. Rptr. 849, 852-53 (1971).

101. *See, e.g.*, CAL. CIV. PROC. CODE § 340.6 (West Supp. 1982) (lawyers); CAL. CIV. PROC. CODE § 340.5 (West Supp. 1982) (doctors).

accountant for negligent misrepresentation should be made? Traditionally, the starting point for analyzing this question has been the same as analyzing liability in other areas: was there a duty between the accountant and the party claiming pecuniary loss? But what is really meant by duty? And how meaningful are the criteria listed in *Biakanja v. Irving*[102] in aiding this inquiry? Isn't there a simpler and more direct approach to this entire question?

Initially, it must be recognized that the question of whether one owes a legal "duty" to another such as to give rise to tort liability for breach of that duty is not really a question at all. It is instead "a shorthand statement of a conclusion . . . [It is only an expression] of the sum total of those considerations of policy which lead the law to say that the particular plaintiff is entitled to protection."[103]

The question of tort liability is more accurately analyzed when the word "duty" is eliminated, with the focus solely on the issue of whether there should be liability. It is certainly discomforting to think that it is in the best interest of society to conclude that where there is no "duty" an individual may act negligently.[104] Not only is it consistent with one's moral responsibilities in a pluralistic and democratic society to recognize that each of us owes a duty to all others to refrain from acting negligently, but a tort analysis which accepts this concept as underlying a rule of liability has the virtue of simplicity.[105] Policy considerations properly limiting liability may then be sharply defined and examined.

Inherent in the tort negligence recovery system is the balancing of costs which society deems important.[106] When some parties are required to bear the financial loss which they have caused to others, not only is this thought to be a fair result in moral terms,

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102. *See supra* notes 49-54 and accompanying text.

103. W. PROSSER, HANDBOOK OF THE LAW OF TORTS § 53 (3d ed. 1964), *quoted in* Dillon v. Legg, 68 Cal. 2d 728, 734, 441 P.2d 912, 916, 69 Cal. Rptr. 72, 76 (1968); *see also* Tarasoff v. Regents of Univ. of California, 17 Cal. 3d 425, 434, 551 P.2d 334, 342, 131 Cal. Rptr. 14, 22 (1976).

104. One would presume we have moved beyond the belief that "a man is entitled to be as negligent as he pleases towards the whole world if he owes no duty to them." LeLievre v. Gould, [1893] 1 Q.B. 491, 497.

105. This approach is generally consistent with California law. In *Rowland v. Christian*, relying on the general statement of negligence liability embodied in CAL. CIV. CODE § 1714 (West 1973), there is a presumption of liability dispensed with only in exceptional circumstances when required by public policy. 69 Cal. 2d 108, 112-13, 443 P.2d 561, 564, 70 Cal. Rptr. 97, 100 (1968).

106. The importance of balancing costs is more obvious in some cases and not others. For example, in denying recovery to a child for loss of a parent's consortium, the California Supreme Court said "[t]he payment of damages to persons for the lost affection and society of a parent or child neither truly compensates for such loss or justifies the social cost in attempting to do so." Borer v. American Airlines, Inc., 19 Cal. 3d 441, 444, 563 P.2d 858, 860, 138 Cal. Rptr. 302, 304 (1977).

but presumably beneficial adjustments occur in the marketplace of behavior and commerce. Accordingly, if the general rule of liability is to be abrogated in favor of accountants, it would seem justified only if there is some external social cause not accounted for in the usual cost balancing system which underlies recovery for negligence.

As noted previously,[107] the California Supreme Court in *Biakanja v. Irving* synthesized a set of factors to use in determining whether the general rule of liability for injury caused by negligence[108] should be dispensed with in a particular instance.[109] To recapitulate, the *Biakanja* court considered

> the extent to which the transaction was intended to affect the plaintiff, the foreseeability of harm to him, the degree of certainty that the plaintiff suffered injury, the closeness of the connection between the defendant's conduct and the injury suffered, the moral blame attached to the defendant's conduct, and the policy of preventing future harm.[110]

Unfortunately, when examined closely, these factors add little or nothing to the question of whether accountants should have a different rule of tort liability.

The "foreseeability of the harm" and "the policy of preventing future harm" are considerations already factored into a traditional negligence determination. There is no need for a court to restrict liability on these bases as a matter of law unless there is insufficient evidence from which a jury could find the defendant negligent.[111] The "closeness of the connection between the defendant's conduct and the injuries suffered" is generally a question of fact for the jury normally considered under a causation rubric.[112] Again, there seems little reason to remove this decision from the jury absent insufficiency of evidence. The "extent to which the transaction was intended to affect the plaintiff" would appear to be relevant only in that it affects the foreseeability of the harm, a factor already considered. It is unclear how "the moral blame attached to the defendant's conduct" would justify a

107. *See supra* text accompanying notes 49-54.

108. *See supra* note 105.

109. Biakanja v. Irving, 49 Cal. 2d 647, 650, 320 P.2d 16, 19 (1958); *see also* Rowland v. Christian, 69 Cal. 2d 108, 112-13, 443 P.2d 561, 564, 70 Cal. Rptr. 97, 100 (1968).

110. 49 Cal. 2d at 650, 320 P.2d at 19.

111. Weirum v. RKO Gen., Inc., 15 Cal. 3d 40, 46, 539 P.2d 36, 39, 123 Cal. Rptr. 468, 471 (1975).

112. *But see* Mosley v. Arden Farms Co., 26 Cal. 2d 213, 220-21, 157 P.2d 372, 376 (1945) (Traynor, J., concurring).

restriction of liability unless defendant's "morality" was in some sense due to relevant but unarticulated policy considerations.

Among the *Biakanja* factors, the only one which might justify a departure from the general rule of liability involves "the degree of certainty that the plaintiff suffered injury." Were a case to arise where the difficulties in proving an injury were so severe as to make the jurors' determination necessarily speculative, courts might be justified in restricting defendant's liability for such injury. In our context, however, this is largely a theoretical problem. No one has suggested any difficulty in proving the fact of injury when an accountant's negligence is involved.

This is not to say, however, that public policy considerations do not exist which justify a departure from the principle of general liability. On occasions, noncompensability of an injury might be a reason.[113] The systemic costs associated with public officials defending against tort suits brought as a result of their discretionary acts is another.[114] Governmental immunity or public official immunity is merely a restriction on liability based on external public policy concerns, but again it is preferable to appreciate that the absence of liability in these cases is because of public policy concerns and not because a public official owes no "duty" to persons who may have been harmed because of his negligence.

In summary, imposition of liability for injury caused by an individual or institution's negligence serves important societal objectives not only in compensating the injured party but also in providing a financial disincentive for socially unreasonable conduct. These important objectives are not to be dispensed with lightly. The general rule of liability for negligence should be limited only where social policy considerations not already part of the negligence determination itself outweigh the need for compensation and behavior modification. The reasons which have been advanced in support of restricting accountants' liability simply fail to overcome this substantial burden. Accordingly, the time has come to confront the inquiry of *Rusch Factors, Inc. v. Levin*[115] and acknowledge that the liability of the accountant should be determined on the basis of foreseeability. Foreseeability of the risk would be a question of fact for the jury to be disturbed on appeal only where there is insufficient evidence to

113. *See* Borer v. American Airlines, Inc., 19 Cal. 3d 441, 446, 563 P.2d 858, 862, 138 Cal. Rptr. 302, 306 (1977).

114. *See* Barr v. Mateo, 360 U.S. 564, 571 (1958); Kilgore v. Younger, 30 Cal. 3d 770, 782, 640 P.2d 793, 800, 180 Cal. Rptr. 657, 664 (1982).

115. *See supra* note 77 and accompanying text.

support that finding.[116]

There are some who might question or criticize this simplistic conclusion for its apparent failure to have given sufficient weight to the burden upon the courts in what inevitably will be complex and costly trials in which the narrow issue will be the accountant's technical failure to have placed the accounting data in proper categories. The essence of this argument is that since accountancy may be more of an art than a science, liability is more properly limited to cases of gross misconduct rather than negligence.[117] Without giving short shrift to this argument, it should be sufficient to respond by asking in what other areas of the law do we trade off actual damages resulting from negligence on the basis of the combined expense of judicial administration and cost to the parties.

Added expense of litigation to the damaged party is always an additional voluntary expenditure which presumably is incurred only after the likelihood of litigation success has been carefully explored. The accountant's added burden of further costs of litigation is only improper if there is a distinct reason why the accountant should be accorded treatment preferential to that received by other classes of potential defendants. If the difficulty and expense of establishing liability were to be the basis for immunizing classes of persons, that classification is clearly best left to the legislature which could weigh not only the cost benefit factors, but the relevant moral considerations. The legislature could then deal with the contention that because of the theoretical possibility that accountants could negligently create enormously complex and costly fact-unraveling trials, they should be relieved of liability for the damages which they have caused. Obviously, taken to its logical end, doctors, lawyers, engineers, and so forth, could also be relieved of liability. Although the legislative re-

116. *See* Weirum v. RKO Gen., Inc., 15 Cal. 3d 40, 46, 539 P.2d 36, 39, 123 Cal. Rptr. 468, 471 (1975).

117. Where the accountant believes he is professionally obligated to qualify his opinion, he should do so. *See supra* text accompanying notes 15-18. The discussion of liability in this paper has proceeded on the premise that the accountant has certified his audit and given an *unqualified opinion* that the financial statements fairly present financial position, results of operations and changes in financial position in conformity with GAAP consistently applied. Whether the element of reasonable reliance could ever be established in those cases where the company issuing the financial statement would itself qualify that statement by expressing an opinion that the statement may have been negligently prepared is beyond the scope of this paper.

sponse is always an unknown, it would hardly appear that any legislature would be sympathetic to this argument. In the absence of legislation, such a judicially-created rule would appear to be demeaning to the fact-finding capability of juries and contrary to the concept of justice underlying our tort recovery system. Moreover, it must be remembered that this argument—the complexities of the principles of accounting practice should give accountants some leeway to avoid liability for errors—is directed not to the scope of the accountant's duty but towards a general rule of immunity. As such, it proves too much. No one has suggested that the negligent accountant not be liable as against the party with whom he contracted, but only that the scope of persons given legal protection against his negligence be limited. Although the issues of duty and liability are necessarily intertwined, elimination of liability by creating immunity necessarily emasculates *any* discussion of duty.

There is some admitted discomfort in saddling the "merely" negligent accountant with economic responsibility for the fraud and dishonesty of the corporate manager. But again, to permit viscerally discomforting responses to control analytical considerations is wholly inappropriate. Tort law traditionally has subordinated these moral considerations to pragmatic concern with foreseeability. It must be remembered that one of the specific functions for which the accountant is employed is the detection of corporate fraud. Accountants and accounting firms derive substantial economic benefit because of their abilities in this regard. It hardly seems oppressive to require that they perform this task in a professionally reasonable manner.[118] The moral imbalance between the accountant's negligence and the corporate manager's fraud—ignored in establishing liability vis-à-vis the foreseeable plaintiff—is considered in the context of indemnification among defendants where adjustment in terms of primary or secondary liability can occur. Thus, where liability is assessed against two or more parties with different degrees of responsibility, indemnification permits the party less culpable to be reimbursed.[119] Inevitably, however, unfairness results in every case where the truly culpable party is insolvent. The legal solution, however, is not to insulate the one party at fault and thereby de-

118. Just as a third person's reliance on a physician's negligent diagnosis of a patient's physical condition is reasonably foreseeable, Molien v. Kaiser Found. Hosp., 27 Cal. 3d 916, 923, 616 P.2d 813, 817, 167 Cal. Rptr. 831, 835 (1980), so too is a third person's reliance on the accountant's negligent diagnosis of the corporation's financial condition.

119. *See generally* American Motorcycle Ass'n v. Superior Court, 20 Cal. 3d 578, 578 P.2d 899, 146 Cal. Rptr. 182 (1978).

prive the injured party of redress. When imperfect justice is compared with no justice at all, the law generally will select the former as being the lesser of two evils.

CONCLUSION

The certified public accountant occupies a critical position in the investment and financial community. As the corporate sector's need to generate business capital continues to increase, so too does the importance of accounting services as the major if not only way to efficiently compile and communicate relevant financial information which serves as the basis for investment decisions. This increase in importance can be defined not only in dollar terms but also in terms of the sheer number of persons and institutions who receive and, as a practical matter, must rely on the accountant's product. When such product is materially in error, investment decisions are skewed which ultimately has adverse effects on the operation of the economy as a whole. More immediately, investors of every size and type suffer significant financial injury as a result of their reliance on the accountant's representations.

The analysis in this article has attempted to demonstrate the social fallacy in retaining the *Ultramares* privity requirement or the *Restatement*'s "actual knowledge" test as the standard for defining the scope of the accountant's liability for negligent misrepresentation. The alternative suggestion—negligence based on the foreseeability of injury—is really nothing new at all but rather the same economically sound standard applied to negligence liability in virtually every other context. The reasons advanced in support of the *Ultramares* and *Restatement* position provide no persuasive rationale for treating accountants differently from any other potential defendants whose negligence causes injury.

Justice Tobriner's landmark opinion for the California Supreme Court in *Dillon v. Legg*[120] exposed the artificiality of judicial determinations that defendants owe no "duty" to plaintiffs:

> The history of the concept of duty in itself discloses that it is not an old and deep-rooted doctrine but a legal device of the latter half of the nineteenth century designed to curtail the feared propensities of juries toward liberal awards. "It must not be forgotten that 'duty' got into our law for the very purpose of combatting what was then feared to be a dangerous delusion (perhaps especially prevalent among juries imbued with popular

120. 68 Cal. 2d 728, 441 P.2d 912, 69 Cal. Rptr. 72 (1968).

notions of fairness untempered by paramount judicial policy), viz., that the law might countenance legal redress for all foreseeable harm."[121]

The time has come to absolve the negligent accountant of this anachronistic protection. Accountant liability based on foreseeable injury would serve the dual functions of compensation for injury and deterrence of negligent conduct. Moreover, it is just and rational judicial policy that the same criteria govern the imposition of negligence liability, regardless of the context in which it arises. The accountant, the investor and the general public will in the long run benefit when the liability of the certified public accountant for negligent misrepresentation is measured by the foreseeability standard.

121. *Id.* at 734, 441 P.2d at 916, 69 Cal. Rptr. at 76 (quoting J. FLEMING, AN INTRODUCTION TO THE LAW OF TORTS 47 (1967)).

APPENDIX

The story of the rise and fall of U.S. Financial (USF) is fascinating reading for those curious as to the whys and wherefores of corporate success and failure. A succinct summary of some of the reasons for USF's financial debacle may be gleaned from the 138-page, 66-count federal indictment dated December 30, 1974[122] in which a number of persons including certain officers and directors of USF were named as principals in the conspiracy to defraud the public by inflating the value of USF's traded stock, and also by reference to the voluminous bankruptcy files which reveal that in 1977, when the financial position of USF was finally unraveled, it had $202,050,000 in claims and an estimated $45,000,000 in assets. The one chapter in the USF saga which will be described in greater detail is that dealing with the claims of two groups of creditors who established to the satisfaction of a jury and judge that because of the negligent misrepresentations of Touche they were damaged in the sum of approximately $22,700,000.[123]

One group of plaintiff creditors, Senior Noteholders, bought $18,000,000 of USF twelve to fifteen-year notes in 1968-1969 under written purchase agreements which required USF to maintain its accounting in accord with generally accepted accounting principles, to furnish financial statements "accompanied by an opinion of independent certified public accountants of recognized national standing" and to furnish annually a certificate that there had been no default and USF had complied with the debt limitations of the agreements.[124] One of the circumstances permitting the acceleration of these notes was false representations by or on behalf of the company. These creditors presented sufficient evidence to satisfy the jury that not only would they have accelerated the notes, but they would have successfully collected them had they not remained passive relying upon Touche's 1970 audit

122. Filed in the United States District Court, Southern District of California, San Diego, California.

123. The discrepancy between the total judgment of $28,800,000 (*see supra* text at note 1) and this sum is that the facts which will be discussed omit another group of creditors. As stated earlier, the reason for discussing the facts is only to add life to what otherwise is a sterile problem. The type of financial event causing damage to a third person relying upon the auditor's statement is only limited by one's imagination. Any legal solution should be sufficiently encompassing to cover any occurrence as unique as that occurrence might be.

124. Touche conceded it owed a duty of care to this category of plaintiffs.

and unqualified opinion of USF's financial affairs.[125]

The other groups of plaintiffs, Deltec Noteholders, were primarily foreign banks who purchased about $11,500,000 in USF's short-term notes from Deltec Banking Corporation, Ltd., a merchant bank and underwriter of private placement securities. In question were three groups of notes with maturity dates of March 15, 1973, May 8, 1973, and May 17, 1973, which were bought between December 15, 1971 and June 30, 1972. They were issued by U.S. Financial Overseas N.V., a wholly-owned subsidiary of USF, and were guaranteed by USF. As part of the agreement of December 13, 1971 between Deltec and USF, USF delivered to the lenders a balance sheet audited as of December 31, 1970, and the unaudited statements as of September 30, 1971, both prepared "in accordance with generally accepted accounting practices and principles." The borrowers and guarantor both covenanted to follow generally accepted accounting principles in keeping their books and to give Deltec a certified consolidated balance sheet at the end of each fiscal year. At trial, these plaintiffs also prevailed proving they never would have bought the notes had the 1970 audit and opinion revealed the true financial situation of USF or, in the alternative, they would have called their loans had the facts been known early enough to save their investments.[126]

The foregoing facts depict just two of the innumerable situations leading to liability for the negligent accounting firm. Admittedly, the result is somewhat paradoxical. Here, Touche was found responsible to creditors who *retained* notes in reliance upon the negligent audit as well as creditors who *purchased* notes based upon the same audit. The former were damaged because had they accelerated the notes they could have *collected* on them;

125. Implicit in this narration is Touche's negligence in the audit of USF. Also implicit is the nature and extent of USF's fraud. USF's not-so-original scam was to inflate income in order to increase the value of its traded stock. This was effected through the illusion that USF had actually sold large parcels of developed or partially developed real estate at a profit when in fact the sales had not occurred. Straw men and shell corporations created and financed by USF were used as purchasers to legitimize what were truly paper transactions. The accountants negligently failed to catch the artificiality of at least two such transactions resulting in a material variance, more than 10 percent, in the certified financial statements. A full discussion of the specific transactions involved and the order of the Securities & Exchange Commission imposing remedial sanctions against Touche appear in Accounting Series Release No. 153, 5 Fed. Sec. L. Rep. (CCH) ¶ 72,175 (1977).

126. The trial court rejected the application of *Ultramares* and left to the jury whether under the circumstances Touche's lack of ordinary care caused a foreseeable injury to the economic interests of plaintiffs. *See* J'Aire Corp. v. Gregory, 24 Cal. 3d 799, 803-06, 598 P.2d 60, 62-64, 157 Cal. Rptr. 407, 409-11 (1979).

the latter were damaged because the notes purchased were found to be *worthless*.[127]

127. The result holding the accountants fully liable for all damages to the prevailing plaintiffs is yet another facet of the problem of the accountant's liability. Assuming a duty absent privity to third parties, should the burden of proof of reliance on the negligently prepared statement be increased to a clear and convincing standard, or should damages be determined by the fair market value of the paper (notes) at the time of the purchase? Analysis of these and similar questions, although relevant to the ultimate effect upon the accountant who may be liable for negligent misrepresentation, is outside the scope of this paper.