

ACCOUNTANT'S NEW LIABILITY IN OKLAHOMA

Angela Ables, Esq.
(405) 272-9221

With everything that is happening on the national front regarding Enron, the accounting firm with whom Enron was associated as well as the continued proliferation of litigation, Oklahoma accountants must contend with a new rule regarding their liability which may impact the insurance industry as well. Until recently, the law of comparative negligence was the rule of law in the state of Oklahoma as it related to most professions, but recently, this rule has come under attack and a new rule of law has been adopted by the Oklahoma Supreme Court as it relates to the profession of accountancy. The "audit interference rule" as originally adopted in the *National Surety v. Lybrand*¹ case adopted very broad parameters for establishing liability of an accountant by setting forth an exception to the rule of contributory negligence. The New York Appellate Division held that "[n]egligence of the [accountant's] employer is a defense only when it has contributed to the accountant's failure to perform his contract and to report the truth."² While this remained the rule of law relating to the accounting profession some sixty (60) years ago, most states had since adopted comparative negligence standards and the rule enunciated in *National Surety* appeared to be the minority rule, that is, until the case of *Stroud v. Arthur Andersen & Co.*³ was decided by the Oklahoma Supreme Court on December 4, 2001, which adopted the *National Surety* rule of the "audit interference" rule as the law of Oklahoma.

Even though the state of New York had written this exception to the law of contributory negligence, it had never been the law in Oklahoma until recently. The rule, never recognized by any Oklahoma court until 1999, was generally thought not to be consistent with the doctrine of comparative negligence which has been the law in Oklahoma for twenty years. The "audit interference rule" was developed to moderate the harsh effect of pure contributory negligence, which at common law could deprive even a slightly negligent Plaintiff of any recovery against a grossly negligent defendant. Courts in states like Oklahoma which recognize comparative negligence have almost universally rejected the rule as inconsistent with the idea of apportionment of fault in negligence actions.

In 1999, this all changed in Oklahoma when a trial court in Oklahoma County utilized the "audit interference rule" in an instruction to a jury in litigation against Arthur Andersen. With its adoption of the rule, the trial court, many thought, had done nothing less than single out the profession of accountancy and deprive members of that profession of any meaningful right to assert the defense of contributory negligence in malpractice actions against them. The jury came back with a fifteen million dollar (\$15,000,000) verdict against the accounting firm and the Oklahoma accounting profession found themselves in the cross hairs of trial lawyers representing any disgruntled client. The award was appealed to the Court of Civil Appeals who ruled that the "audit interference rule" instruction by the trial court was erroneous and the judgment was reversed. The Oklahoma Supreme Court granted certiorari and vacated the Court of Appeals decision and affirmed the District Court judgment. Alone among Oklahoma professionals, accountants now find themselves barred from having a jury hear, much less consider a client's negligence unless it falls within the narrow parameters of the "audit interference rule."

While accountants are skilled professionals retained for their expertise, a California Court of Appeals stated it best, when it noted in the case of *Linder v. Barlow, Davis & Wood*.⁴ "Those who hire such experts are not justified in expecting infallibility, but can only expect reasonable care and competence. They purchase service, not insurance."⁵ Many feared that the ultimate result of the trial court's decision would be to turn accountants from professional experts into insurers for the continued solvency of any business which they audit. Skyrocketing costs of accountant services may well result from this ruling and many smaller accounting firms may be forced out of the auditing business altogether.

In the 1990's, a number of Oklahoma accounting firms were forced into bankruptcy as a result of lawsuits initiated against them under various causes of action. Appellants argued that public policy mandated that accounting firms be able to provide auditing services to the public without being held responsible for defalcations which are hidden by the perpetrator. Appellants argued that utilizing the "audit interference rule" as an instruction to the jury on contributory negligence was improper since instructing the jury based upon the audit interference rule, a rule which

had never been recognized in Oklahoma, and which had no place in a state which had adopted the law of comparative negligence statutorily, that the court violated the Defendant Accounting firm's right, under Article 23 § 6 of the Oklahoma Constitution, to have its defense of contributory negligence go to the jury.

In 1979 the Oklahoma Legislature adopted the doctrine of comparative negligence with the enactment of 23 O.S. § 13. The new law swept away the harsh vestiges of the common law doctrine of contributory negligence, where even the slightest negligence by a plaintiff had been enough to defeat any recovery, and instituted a more equitable approach founded on "attaching liability in direct proportion to the fault of each entity whose negligence caused the damage." *Bode v. Clark Equipment Co.*⁶ The adoption of comparative negligence in Oklahoma and other jurisdictions has rendered obsolete many of the old causation doctrines which mitigated the arbitrariness of pure contributory negligence.

In the case described herein, the trial court invoked this obsolete rule, never before recognized in Oklahoma, and modified OUJI⁷ Instruction Number 9.17 on contributory negligence, instructing the jury as follows:

Under the law you may not find that Plaintiffs were negligent unless you also find that Plaintiffs' negligence contributed to Defendant's failure to perform its audit work. This means, however, that Plaintiffs' conduct must have been unreasonable under the circumstances and interfered with Defendant's ability to perform its duty . . . If you find that Plaintiff's negligence did not contribute to Defendant's failure to perform its audit work, then you may not compare the negligence of the Plaintiffs to the negligence of the Defendant (Court's Instruction No. 16).

With this jury instruction, the trial court ignored the whole concept of comparative negligence which has been the law in Oklahoma for 20 years. By adopting the audit inference rule the court deprived the Defendant Accounting firm of its right to have the jury consider the Plaintiff's significant role in causing the damages. The trial court's decision re-wrote the law and deprived the profession of accountancy of the right to assert the defense of contributory negligence in malpractice actions.

The audit interference rule was originated 60 years ago in the New York courts as an attempt to mitigate the harsh consequences of the pure contributory negligence rule then in effect in the state. The seminal case, *National Surety Corp. v. Lybrand*,⁸ involved an auditor's failure to uncover embezzlement by a cashier at a financial institution. In response to the auditor's defense of contributory negligence, the court refused to permit accountants to escape from "... the consequences of their negligence because those who employ them have conducted their own business negligently."⁹ Thus, the court held, the Plaintiff's negligence could only serve as a defense to the extent that such negligence actually interfered with the Defendant's conduct of the audit.

In the years since the *National Surety* case was decided, several other courts have adopted the audit interference rule. Significantly, these decisions have come almost exclusively in jurisdictions which did not recognize comparative negligence at the time the decision was rendered. States, like Oklahoma, which do recognize comparative negligence, on the other hand, had almost universally rejected the rule.

As far as can be determined, based on reported decisions, seven jurisdictions have adopted the rule, while 12 jurisdictions have specifically rejected it.¹⁰

Interestingly, courts in New York, where the rule of audit interference first arose, have called the rule into question since that state adopted comparative negligence. In the relatively recent case of *Bank Brussels Cambert v. Chase Manhattan Bank*,¹¹ the Federal District Court for the Southern District of New York noted, "New York has abandoned contributory negligence as an absolute defense, and adopted a comparative fault regime. That fact of itself calls into question the continued vitality of *National Surety*." (Pg. 1 of the Court's Opinion).

In one of the most recent reported decisions in the area, *Standard Chartered PCL v. Price Waterhouse*, supra, the Arizona Court of Appeals, refused to apply the audit interference rule, explaining:

[T]he rationale of *National Surety* is incompatible with Arizona law. In New York, at the time of *National Surety*, contributory negligence was a complete defense. In Arizona, contributory negligence has never

been a complete defense; see Ariz. Const. Art 18, § 5; and we are now a state of several liability and comparative fault; see A.R.S. §§ 12-2501 to 2506. (945 P.2d at 352)

In another 1996 case, *Scioto Memorial Hosp. Association v. Touche Ross & Co.*, supra, the Ohio Supreme Court also declined to follow *National Surety's* audit interference rule. After an analysis of the case law from other jurisdictions, the Court concluded:

The audit interference rule was made to soften what was then the harsh rule of negligence law that barred recovery of damages if there was any contributory negligence on the part of the plaintiff However, in light of Ohio's comparative negligence statute enacted in 1980, R.C. 2315.19(A), there is no need for a special rule and, thus, we reject the application of the audit interference rule in Ohio.

The only reported decision from a comparative negligence jurisdiction to adopt the audit interference rule recently is a 1990 Tenth Circuit opinion applying Utah law, *Fullmer v. Wohfeiler & Beck*.¹² In *Fullmer*, the Plaintiffs were investors who had relied on an audit in making loans to a business which subsequently failed. The alleged comparative negligence was in the Plaintiffs' failure to memorialize or securitize their loans. The Plaintiff investors were not involved in the management of the failed business. The Plaintiffs did not participate in or provide any information for the audit at issue. In the *Fullmer* case, the Court predicted that the Utah Supreme Court would adopt the *National Surety* rule limiting accountants' right to invoke the comparative negligence defense.¹³ In its rather recent *Steiner Corp. v. Johnson & Higgins of California*¹⁴ case, the Tenth Circuit extended its application of the *National Surety* rule under Utah law to include all professionals, including actuaries, physicians and attorneys.¹⁵

In the Oklahoma case utilization of the audit interference rule and resulting modification of OUJI Instruction Number 9.17, the trial court prevented any presentation of the Defendant's contributory negligence defense to the jury under the applicable Oklahoma law of comparative negligence.

Article 23 § 6 of the Oklahoma Constitution provides:

The defense of contributory negligence or of assumption of risk shall, in all cases whatsoever, be a question of fact, and shall, at all times, be left to the jury.

The exceptionally strong, "in all cases whatsoever" language of the provision reflects the fundamental nature of the right under Oklahoma law.

In the Oklahoma Supreme Court case of *Haynie v. Haynie*,¹⁶ the Court stated:

[I]f there is any evidence of contributory negligence or from which contributory negligence may be inferred or presumed, the issue must be left to the jury, and the verdict on that issue is conclusive. Citing *Cosmo Construction Co. v. Loden*.¹⁷

The audit interference rule has never been the law in Oklahoma until now. Although many believed the audit interference rule had no place in a state like Oklahoma which recognizes the doctrine of contributory negligence, it is now the law in our state. The Oklahoma Supreme Court in affirming the decision of the trial court stated:

"In our quest to determine the relevance of the plaintiff's conduct to a professional-negligence claim, we find the legal analysis of *National Surety*¹⁸ and the Tenth Circuit of the U. S. Circuit Court of Appeals' decisions in *Fullmer v. Wohfeiler & Beck*¹⁹ and *Steiner Corp. et al. v. Johnson & Higgins of California*²⁰ to be persuasive. There the courts held that an accountant could assert as a defense the plaintiff's own negligent acts when such conduct contributed to the accountant's failure to perform his/her work. As noted by the Tenth Circuit, to hold otherwise would render illusory the notion that an accounting firm is negligent when its performance breaches the duty of care it owes as a professional to the public and causes injury. An accountant cannot defend his/her deficient professional conduct by asserting that its client was also negligent unless the client's conduct can be proven to have interfered with the accountant's provision of professional services. Today's clarification of the proof necessary to establish a prima facie case of

professional negligence does not prevent Andersen from asserting – as it did – that the damages for which Stroud/SCI seek compensation did not flow or result from its [the auditor’s] conduct. It does prevent the defendant from excusing its liability for professional negligence by interjecting facts into the trial which are unrelated to the issue of its responsibility for negligently-provided professional services.”²¹

The effect of this ruling has yet to be seen; audits may become, in effect, a bond for the audited business’ solvency. Accountants may be deemed to be insurers of sorts. One thing is sure: we haven’t seen the last of lawsuits against accountants and this liberalization of their liability may continue nationwide due to the public reaction of headlines we see forthcoming out of the Enron demise.

Endnotes

1. 256 A.D. 226, 9 N.Y.S.2d 554 (1939).
2. 9 N.Y.S.2d at 563.
3. 37 P.3d 783 (2001).
4. 210 Cal. App. 2d 660, 27 Cal. Rptr. 101 (Cal. App. 1st Dist., 1963).
5. 210 Cal. App. 2d at 665.
6. 719 P.2d 824, 827 (Okla. 1986).
7. Oklahoma Uniform Jury Instructions.
8. 256 A.D. 226, 9 N.Y.S.2d 554 (1st Dept. 1939).
9. 9 N.Y.S.2d at 563.
10. Jurisdictions *adopting* the audit interference rule:

Illinois – *Cereal Byproducts Co. v. Hall*, 132 N.E.2d 27 (Ill. App. 1956); *Holland v. Arthur Andersen & Co.*, 469 N.E.2d 419 (Ill. App. Ct. 1984).

Kansas – *Comeau v. Rupp*, 810 F.Supp. 1172 (D.Kan. 1992).

Nebraska – *Lincoln Grain v. Coopers & Lybrand*, 345 N.W.2d 300 (Neb. 1984).

New York – *National Surety v. Lybrand*, 9 N.Y.S.2d 554 (1939).

Pennsylvania – *Jewelcor Jewelers & Distributors, Inc. v. Corr*, 542 A.2d 72 (Pa. Super. 1988).

Texas – *Greenstein, Logan & Co. v. Burgess Marketing, Inc.*, 774 S.W.2d 170 (Tex. Ct. App. 1987).

Utah – *Fullmer v. Wohfeiler & Beck*, 905 F.2d 1394 (10th Cir. 1990).

Jurisdictions *rejecting* the audit interference rule:

Arizona – *Standard Chartered P.L.C. v. Price Waterhouse*, 945 P.2d 317 (Ariz. Ct. App. 1996).

Arkansas – *F.D.I.C. v. Deloitte & Touche*, 834 F.Supp. 1129, 1143-47 (E.D. Ark. 1992).

Colorado – *R.T.C. v. Deloitte & Touche*, 818 F.Supp. 1406 (D.Colo. 1993).

Florida – *Devco Premium Finance Co. v. North River Ins. Co.*, 450 So.2d 1216 (Fla. Dist. Ct. App. 1984).

Iowa – *American Trust & Savings Bank v. U.S.F. & G.*, 439 N.W.2d 188, 190 (Iowa 1989).

Louisiana – *National Credit Union Admin. Bd. V. Aho, Henshue & Hall*, 1991 WL 174671 (E.D. La. 1991).

Maryland – *Wegand v. Howard Street Jewelers*, 605 A.2d 409 (Md. 1992).

Michigan – *Capital Mortgage Corp. v. Coopers & Lybrand*, 359 N.W.2d 922 (Mich. Ct. App. 1985).

Minnesota – *Halla Nursery Inc. v. Baumann Furrie & Co.*, 454 N.W.2d 905 (Minn. 1990).

Ohio – *Scioto Memorial Hosp. V. Price Waterhouse*, 659 N.E.2d 1268 (Ohio 1996), (3) and *American Nat'l Bank v. Touche, Ross & Co.*, 659 N.E.2d 1276 (Ohio 1996).

Tennessee – *Delmar Vineyard v. B.A. Timmons, C.P.A.*, 486 S.W.2d 914 (Tenn Ct. App. 1972) and *McCaslin v. Wood*, 1993 W.L. 8015 (Tenn. Ct. App. 1993).

Wisconsin – *Inmark Industries Inc. v. Arthur Young & Co.*, 436 N.W.2d 311 (Wis. 1989).

11. 1996 WL 728856 (S.D. N.Y. Dec. 18, 1996).
12. 905 F. 2d 1394 (10th Cir. 1990).
13. 905 F.2d at 1398-99.
14. 135 F.3d 684 (10th Cir. 1998).
15. 135 F.3d at 688-90.
16. 426 P.2d 717, 724 (Okla. 1967).
17. 352 P.2d 910 (Okla. 1960).
18. *See* endnote 1.
19. *See* endnote 10.
20. *See* endnote 12.
21. *Stroud v. Arthur Andersen & Co.*, *supra*.