



by Michael A. Nelson

Accountant malpractice: The comparative negligence defense in Maine

ACCOUNTANT MALPRACTICE CASES GENERALLY FALL within one of three categories: embezzlement cases, client reliance cases, and third-party reliance cases.

In the first category, the accountant is alleged to have conducted a negligent audit that failed to uncover embezzlement or other forms of defalcation by employees or agents of the client. The second category involves allegations of negligent advice directed to the client. The third is based upon allegations of negligent opinions, services, or advice relied upon by third parties such as lenders, investors, or sureties. Because there is no privity of contract between the accountant and such third parties, those cases must rely upon a negligent misrepresentation cause of action under Restatement (Second) of Torts, section 552, which has been adopted in Maine. *Allied Inv. Corp. v. KPMG Peat Marwick*, 872 F. Supp. 1076, 1085 (D. Me. 1995).

In 1965, the Maine Legislature enacted the comparative negligent statute, Title 14 M.R.S.A. section 156, which replaced the common-law affirmative defense of contributory negligence. Under the contributory negligence regime, the plaintiff was foreclosed from any recovery whatsoever if he or she was negligent, even in the slightest. The comparative negligence statute in Maine (as well as comparative negligence statutes or decisions in nearly every other jurisdiction) replaced the harsh all-or-nothing approach of contributory negligence with a formulation based upon allocation of fault. In Maine, the plaintiff can recover (albeit in a reduced amount) if the plaintiff is found to be less than 50 percent at fault.

Historically, there has been a divergence of authority among the states as to whether contributory negligence (or comparative negligence) is available as an affirmative defense in accountant malpractice cases. The Maine Supreme Judicial Court, acting

as the Law Court, has not directly addressed this issue. This article will describe the status of the law generally and explain why Maine's comparative negligence statute should be available in cases of accountant malpractice, as it is in malpractice cases against other professionals such as physicians and attorneys.*

The rise and fall of the National Surety (Audit Interference) Rule

THE FIRST CASE TO ADDRESS THE AVAILABILITY OF THE contributory negligent defense in accountant malpractice cases was an embezzlement case from New York, *Craig v. Anyon*, 208 N.Y.S. 259 (N.Y. App. Div. 1925). In *Craig*, an employee of a commodities broker embezzled more than \$1.25 million from the firm. The firm sued its accountants, alleging that they failed to discover the embezzlement because they negligently audited the firm's financial statements. The accountants asserted a contributory negligence defense, contending that the commodities brokerage's negligent supervision of the employee allowed the embezzlement to occur. The New York appellate court allowed the accountants' contributory negligence defense and denied the brokerage firm any recovery because "the loss was not entirely the result of the negligence of the defendants, but also resulted from the careless and negligent manner in which the plaintiffs conducted their business." *Id.* at 267. The court found that the brokerage firm had a duty to exercise reasonable care in the conduct of its business and breached that duty, leading, at least in part, to the

* This article addresses malpractice claims that sound in tort, not those which may be based upon a breach of contract claim. However, even if such a breach of contract case were available, the negligence of the client may be relevant on issues such as causation and mitigation of damages.

loss. As the court stated: “There is no doubt in this case that plaintiffs could have prevented the loss by the exercise of reasonable care, and that they should not have relied exclusively on the accountants.” *Id.* at 267–268.

Eleven years later, the New York appellate court switched gears in another embezzlement case, *National Surety Corporation v. Lybrand*, 9 N.Y.S.2d 554 (N.Y. App. Div. 1939), and substantially limited the availability of contributory negligence as an affirmative defense in accountant malpractice cases. In *National Surety*, the accountants were engaged to audit the financial statements of a brokerage firm. The audit failed to uncover embezzlement by a cashier in the firm’s main office of approximately \$300 thousand. *National Surety*, as surety for the brokerage firm, paid the loss and then sued the accountants for malpractice. The accountants raised a contributory negligence defense arguing that the firm’s negligent operation of its business led to the loss barring any recovery. The court rejected the defense raised by the accountants. The court recognized that contributory negligence could constitute a defense to a malpractice claim against accountants, but held that such a defense was limited to those instances in which the client’s negligence interfered with the conduct of accountant’s audit. As the court stated:

We are, therefore, not prepared to admit that accountants are immune from the consequences of their negligence because those who employ them have conducted their own business negligently. . . . Negligence of the employer is a defense only when it has contributed to the accountant’s failure to perform his contract and to report the truth.

Nat. Sur. Corp., 9 N.Y.S.2d at 563.

This decision became known as the *National Surety* rule (or the “audit interference rule”). It arose at least in part as a means of tempering the harsh all-or-nothing approach of common law contributory negligence, which prohibited any recovery and immunized accountants from liability if the plaintiff was found to be in the least bit negligent. *FDIC v.*

Deloitte & Touche, 834 F. Supp. 1129, 1146 (E.D. Ark. 1992); *Capital Mortgage Corp. v. Coopers & Lybrand*, 369 N.W. 2d 922, 925 (Mich. Ct. App. 1985); *Devco Premium Fin. Co. v. North River Ins. Co.*, 450 So. 2d 1216, 1220 (Fla. Ct. App. 1984); Robert A. Prentice, *Can the Contributory Negligence Defense Contribute to a Diffusing of the Accountant’s Liability Crisis?* 13 WIS. INT’L L.J. 359 (1995).

Since the *National Surety* case in 1935, nearly every state has rejected the all-or-nothing approach of common law contributory negligence and replaced it either by statute or opinion with some form of comparative fault. Only four states—Alabama, Maryland, North Carolina, and Virginia—and the District of Columbia have retained common-law contributory negligence. Jordan H. Liebman et al., *The Rise and Fall and Perhaps Rise Again of the “Blindfold” Rule in Modified Comparative Fault Cases: A Proposed Experiment*, 102 DICK.L.REV. 33 (1997). The rest have replaced it with some form of apportionment of the damages based upon comparative fault. As mentioned above, the Maine Legislature adopted its version of comparative negligence in 1965.

The change from contributory negligence to comparative fault also prompted widespread reconsideration of the *National Surety* rule. Because the comparative negligence approach did not totally immunize defendants from liability if the plaintiff was the slightest bit negligent, a major rationale for the *National Surety* rule was removed. Jurisdiction after jurisdiction has since rejected the rule in all categories of accountant malpractice cases.

For example, in *Halla Nursery Inc. v. Baumann-Furrie & Co.*, 454 N.W.2d 905 (Minn. 1990), a corporation brought a negligence action against its accounting firm because the firm’s audit failed to reveal embezzlement by a corporate employee. The accounting firm raised the affirmative defense of comparative negligence under Minnesota’s comparative negligence statute, Minn. Stat. §604.01, arguing that the corporation allowed the embezzlement to occur by failing to use reasonable care in the operation of its business. The corporation countered with the *National Surety* rule, contending that the firm’s comparative negligence defense must fail as a matter of law because there was no evidence that the corporation interfered with the accountants’ audit. The Minnesota Supreme Court rejected the *National Surety* rule, allowed the accountants to assert a comparative negligence defense, and affirmed the jury’s apportionment of damages between the accountants and the corporation based upon their respective fault. The court held that accountants, like other profes-



Michael Nelson is a member of Jensen, Baird, Gardner & Henry, where he practices commercial litigation, professional liability, and antitrust law. He is listed in Best Lawyers in America (business litigation and legal malpractice) and is chairman of the Maine Supreme Court Advisory Committee on Professional Responsibility. Brendan P. Rielly, also a member of Jensen, Baird, Gardner & Henry, contributed to the preparation of this article

sionals, should be afforded the protection of the statutory comparative negligence defense. As the court stated:

Because we have broadly construed the comparative fault act and applied it to other professional malpractice actions, we reverse the court of appeals and hold that the trial court did not err in applying the principles of comparative fault in this action by a client against an accountant for negligent failure to discover embezzlements in the client's business.

Halla Nursery, Inc., 454 N.W.2d at 909.

The Ohio Supreme Court reached a similar conclusion in a client reliance case—*Scioto Memorial Hospital Association v. Price Waterhouse*, 659 N.E.2d 1268 (Ohio 1996). In that case, Scioto Memorial Hospital Association brought suit against its accounting firm, Price Waterhouse, alleging that the firm prepared a negligent financial feasibility study for Scioto's investment in a residential retirement center. Price Waterhouse pleaded comparative negligence as an affirmative defense, but the trial court excluded the defense under the *National Surety* rule. The Ohio Supreme Court reversed and expressly rejected the *National Surety* (audit interference) rule, stating as follows:

The audit interference rule was made to soften what was then the "harsh rule" of negligence law which barred recovery of damages if there was any contributory negligence on the part of the plaintiff. [Citations omitted]

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. Hence, any negligence by a client, whether or not it directly interferes with the accountant's performance of its duties, can reduce the client's recovery. In so holding, we note that virtually all courts that have expressly considered the applicability of the audit interference rule to their comparative negligence states have agreed and rejected the rule. [Citations omitted]

Scioto Mem'l Hosp. Ass'n, 659 N.E.2d at 477.

The Washington Supreme Court followed suit in a third-party reliance case, *ESCA Corp. v. KPMG Peat Marwick*, 959 P.2d 651 (Wash. 1998). In that case a

bank brought a negligent misrepresentation claim against an accounting firm that had audited the financial statements of a company to which the bank had loaned money. The firm asserted a comparative negligence case against the bank. The court found that the Washington comparative negligence statute, RCW 4.22.005 governs cases of negligent misrepresentation such as this one and affirmed an allocation of the damages in accordance with that statute. Indeed, as one commentator has noted, there is even less rationale for the *National Surety* limitation on the accountant's comparative negligence defense in such third-party cases:

At least in the employee defalcation scenario, the client/plaintiff can argue: "I hired this auditor; I'm entitled to rely on her report." In the third-party scenario, the plaintiff does not hire the auditor. Thus, its right to rely upon the auditor at all is open to heated debate. It should be beyond question that the third-party has no right to rely so totally that it need not exercise any care on its own behalf.

Robert A. Prentice, *Can the Contributory Negligence Defense Contribute to a Defusing of the Accountants' Liability Crisis?* 13 WIS. INT'L L.J. 359, 414 (1995)

Most courts agree that the *National Surety* rule is out of date, unnecessary, and no longer controlling in light of modern comparative negligence law. Indeed, even the federal court in New York (where the *National Surety* rule originated nearly seventy years ago) has found that it is unnecessary in light of New York's adoption of comparative negligence. As the court stated in *Bank Brussels Lambert v. The Chase Manhattan Bank*, 1996 W.L. 728356 (S.D.N.Y. 1996):

[S]ince *National Surety*, New York has abandoned contributory negligence as an absolute defense, and adopted a comparative fault regime. See N.Y.C.P.L.R. 1411 (added 1975). That fact of itself calls into question the continued vitality of *National Surety* even in those cases when the parties do stand in an employee-employer relationship to each other. ... *Under a comparative fault regime, there does not appear to be any sound policy reason to apply National Surety.*

Bank Brussels Lambert (emphasis added). Accord *Standard Chartered PLC v. Price Waterhouse*, 945 P.2d 317, 353 (Ariz. Ct. App. 1997) ("We hold, therefore, that the *National Surety* doctrine

does not apply in Arizona, and does not impede the jury's allocation of United's relative degree of fault."); *Ward v. Vizzini*, 695 So. 2d 1012 (La. Ct. App. 1997); *Am. Nat'l Bank v. Touche Ross & Co.*, 659 N.E.2d 1276 (Ohio 1996); *Resolution Trust Corp. v. Deloitte & Touche*, 818 F. Supp. 1406 (D. Colo. 1993) (interpreting Colorado law); *FDIC v. Deloitte & Touche*, 834 F. Supp. 1129, 1146 (E.D. Ark. 1992) (interpreting Arkansas law and noting that "without the harsh consequences of a contributory negligence rule, a *National Surety* – type exception to the broadly applicable principle of comparative fault is not necessary or desirable."); *Wegad v. Howard St. Jewelers*, 605 A.2d 123 (Md. 1992) (contributory negligence state); *Maduff Mortgage Corp. v. Deloitte Haskins & Sells*, 779 P.2d 1083 (Or. Ct. App. 1989); *Univ. Nat'l Bank v. Ernst & Whinney*, 773 S.W.2d 707 (Tex. Ct. App. 1989); *Capital Mortgage Corp. v. Coopers & Lybrand*, 369 N.W.2d 922 (Mich. Ct. App. 1985); *Devco Premium Fin. Co. v. North River Ins. Co.*, 450 So. 2d 1216 (Fla. Dist. Ct. App. 1984); *Vinyard v. Timmons*, 486 S.W.2d 914 (Tenn. Ct. App. 1972).

A handful of comparative negligence jurisdictions have gone the other way, adopting or reaffirming the validity of *National Surety*. The most recent case was in Illinois, *Board of Trustees v. Coopers & Lybrand*, 775 N.E.2d 55 (Ill. App. Ct. 2002). In that case a college brought a negligence action against its accountants for failing to detect risky investments of the college's treasurer. The court rejected the accountants' comparative negligence defense under the *National Surety* rule. The court noted that since Illinois had adopted the *National Surety* rule before it adopted a comparative negligence statute, and that the comparative negligence statute did not expressly abrogate the *National Surety* rule, the *National Surety* rule survived enactment of the statute. As the court stated:

The audit interference doctrine has a foundation in Illinois common law [citations omitted]. Common law rights and remedies are in full force in this state unless repealed by the legislature or modified by a decision of our courts [citation omitted]. It is also well-established law that legislation intending to abrogate the common law must be clearly and plainly expressed. [Citation omitted]. The Accounting Act and the Code do not clearly express the intent to abrogate the audit interference doctrine."

Board of Trustees, 775 N.E.2d at 69.

The other comparative negligence states retaining the *National Surety* rule are Missouri—*Garnac Grain Co. v. Blackley*,

932 F.2d 1563 (8th Cir. 1991) (interpreting Missouri law); Utah—*Fullmer v. Wohlfeiler & Beck*, 905 F.2d 1394 (10th Cir. 1990) (interpreting Utah law); Nebraska—*Lincoln Grain, Inc. v. Coopers & Lybrand*, 345 N.W.2d 300 (Neb. 1984); and Pennsylvania—*Jack Greenberg, Inc. v. Grant Thornton*, 240 B.R. 486 (E.D. Pa. 1999) (interpreting Pennsylvania law).

Under the current state of the law, the overwhelming majority of jurisdictions which have adopted comparative negligence have rejected the *National Surety* rule. Similarly, Maine should adopt this majority position.

Maine should adopt the majority rule and recognize comparative negligence as an affirmative defense in accountant malpractice cases

Maine never adopted the *NATIONAL SURETY* RULE BEFORE the Maine Legislature replaced contributory negligence with comparative negligence in 1965. There are a number of reasons based in law and policy for the Law Court to reject *National Surety* now.

First, the plain language of the comparative negligence statute encompasses all cases involving "negligence, breach of statutory duty or other act or omission that gives rise to a liability in tort." 14 M.R.S.A. §156 (2003). The Law Court has stated that "[b]y selecting that broadly inclusive language, the legislature displayed an intention to make *all tort actions* subject to the § 156 defense." *Austin v. Raybestos-Manhattan Inc.*, 471 A.2d 280, 284 (Me. 1984) (emphasis added). Under fundamental principles of statutory construction, the court first looks to the plain meaning of a statute for its interpretation. *York Mut. Ins. Co. v. Bowman*, 2000 ME 27, ¶5, 746 A.2d 906, 907. There is nothing in the plain meaning of Maine's comparative negligence statute that would suggest accountants are exempt from its protection. Moreover, unlike Illinois, where the *National Surety* rule was part of the state's common law before adoption of comparative negligence, the *National Surety* rule was never recognized in Maine. It was not part of Maine's common law and, therefore, it could not survive the adoption of a comparative negligence statute as it did in Illinois. *Board of Trustees v. Coopers & Lybrand*, 775 N.E. 2d 55, 266 (Ill. App. Ct. 2002).

Further, the comparative negligence statute is available as an affirmative defense in other professional malpractice cases, such as those against physicians and attorneys. *Walker v. Maine General Med. Ctr.*, 2002 Me. 46, ¶ 11, 792 A.2d 1074, 1077–78

(upholding comparative negligence defense in medical malpractice actions); *Pinkham v. Burgess*, 933 F. 2d 1066, 1072–74 (1st Cir. 1991) (holding that the comparative negligence defense is available in attorney malpractice actions in Maine); *Wheeler v. White*, 1998 ME 137, ¶ 10, 714 A 2d 125, 127–28 (applying comparative negligence analysis in an attorney malpractice case). There is no basis in the language of the statute or in public policy for excluding accountants from the protection enjoyed by physicians and attorneys. As the First Circuit stated in *Pinkham*: “This language [14 M.R.S.A. § 156] suggests no exceptions to the applicability of the doctrine for certain kinds of torts. See *Austin v. Raybestos Manhattan Inc.* 471 A. 2d 280, 284 (Me. 1984) (legislature intended to make all tort actions subject to defense under this section).” 933 F. 2d at 1073.

Indeed, U.S. District Judge D. Brock Hornby recently gave the jury a Title 14 M.R.S.A. section 156 comparative negligence instruction in an action alleging negligent misrepresentation and professional negligence against an accounting firm. *Bookland of Maine v. Baker, Newman & Noyes, LLC*. (Docket No. Civ-01-234-P-H).

Finally, allowing accountants to invoke the comparative negligence defense without the restrictions of the *National Surety* rule would be consistent with the policy behind the comparative negligent statute. Accountants should be held responsible for damages caused by their carelessness, but no more so than clients or third parties who may have made claims against them. If clients or third parties are negligent, and that negligence contributes to their claimed damage, then they as well should be held accountable for the damage that they have caused. That is the intent of the comparative negligence statute as enacted by the Legislature years ago.

Conclusion

THERE MAY HAVE BEEN SOME JUSTIFICATION FOR THE *NATIONAL Surety* rule under the harsh contributory negligence regime that prevailed years ago when the rule was developed. That justification no longer exists. Accountants, like other professionals, are entitled to assert a comparative negligence defense under the statute without the type of limitation that the *National Surety* rule would impose. ▀



Donald E. Saastamoinen, B.S., M.S.

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**Lambert
Coffin**
attorneys at law

(207) 874-4000
Fax (207) 874-4040
www.lambertcoffin.com