

## New Jersey Outline on Accounting and Auditing Liability Issues

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### A. Nature of Malpractice Claim (Tort, Contract, etc)

In New Jersey, accountant liability is governed by the Accountant Liability Act (“the Act”), which provides that an accountant will be liable for negligence arising out of and in the course of rendering accounting services to a client.<sup>1</sup> However, under the Act an accountant is *not* insulated from liability for intentional conduct, including aiding and abetting or fraud.<sup>2</sup>

### B. Standing/Existence of Duty

#### 1. Clients

In New Jersey, under the Act a “client” is defined as the party directly engaging an accountant to perform a professional accounting service.<sup>3</sup> The Act specifically limits the liability of accountants to claims raised by clients, except for limited statutorily proscribed circumstances where knowledge and intent to rely upon the services of the accountant is established at the time of the work. Under New Jersey law an accountant’s liability is defined by the scope of the engagement it entered.<sup>4</sup> The duty owed to another is defined by the relationship between the parties and any negligence must be based on the scope of that, or related, understandings and agreements to determine whether the defendant violated any duty.<sup>5</sup> However, it has been held that an accountant did not have a duty to a third-party claimant when there was no contractual relationship between the parties.<sup>6</sup>

#### 2. Trustees and Receivers

In New Jersey, the receiver or trustee of an insolvent or liquidated business has standing to assert accounting malpractice claims based upon duties to the prior business. New Jersey Courts

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<sup>1</sup> N.J.S.A. 2A:53A-25.

<sup>2</sup> State Dep’t of Treasury, Div. of Inv. ex rel. McCormac v. Qwest Communications Intern., Inc., 387 N.J. Super. 469 (App. Div. 2006).

<sup>3</sup> N.J.S.A. § 2A:53A-25(a)(3).

<sup>4</sup> Cast Art Indus., LLC v. KPMG LLP, 209 N.J. 208, 226 (2012) *citing* NCP Litig. Trust v. KPMG LLP, 187 N.J. 353, 382 (2006).

<sup>5</sup> NCP Litig. Trust v. KPMG LLP, 187 N.J. 353, 382 (2006). In this case, there was a contractual relationship to conduct auditing services.

<sup>6</sup> Finderne Mgmt. Co., Inc. v. Barrett, 355 N.J. Super. 197 (App. Div. 2002), cert. denied, 177 N.J. 219 (2003).

may recognize a “deepening insolvency” theory to support such claims against accountants.<sup>7</sup> Such a claim contends that the accountant artificially prolonged, or contributed to the artificial prolongation of, the business’s life, thereby increasing the debt, depleting the assets and increasing exposure to creditors.<sup>8</sup>

### 3. Assignees of Clients

In New Jersey the assignment of an accounting malpractice claim may be recognized, but the assignee can have no greater rights than the assignor and can recover no more than the assignor could have recovered.<sup>9</sup>

### 4. Third Parties/Non-Clients

In New Jersey liability to non-client, based upon negligence, requires satisfaction of a three-prong statutorily proscribed test. Under the Act, an accountant will not be liable for damages arising from negligent professional accounting services unless the claimant was the account’s client or *all* three criteria are established.<sup>10</sup> Under the Act, non-client liability requires the claimant to establish: (1) the accountant knew at the time of the engagement that the accounting services would be made available to the claimant<sup>11</sup>; (2) the accountant knew the claimant intended to rely upon the accounting services in connection with a specified transaction; and (3) the accountant directly expressed to the claimant by words or understanding to the claimant that the accountant understood that the claimant would rely upon the services.<sup>12</sup> However, in the case of a non-client bank claimant, the accountant must have acknowledged the bank’s intended reliance on the accounting service in a written communication.<sup>13</sup>

The Act does not shield accountants from intentional acts of fraud, from intentional acts which assist a client in committing a fraud or from conspiratorial cooperation aimed at perpetration of fraud. The plain language of the Act limits its provisions to and precludes extension beyond

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<sup>7</sup> NCP Litig. Trust v. KPMG LLP, 399 N.J. Super. 606 (Law Div. 2007);

<sup>8</sup> Ibid.

<sup>9</sup> NCP Litig. Trust v. KPMG LLP, 187 N.J. 353, 390 n.3 (2006)(acknowledging the assignment of accounting malpractice claim to a trust)( Justice LaVECCHIA, dissenting) *citing* Boyd v. Brown, 115 N.J.L. 611 (E. & A.1935).

<sup>10</sup> N.J.S.A. § 2A:53A-25(b).

<sup>11</sup> “At the time of the engagement by the client” refers to the outset of the engagement rather than at any time during the period of the engagement. Cast Art Indus. v. KPMG LLP, 209 N.J. 208, 224-225 (2012).

<sup>12</sup> Knowledge that the claimant intended to rely on his services in connection with that specified transaction is not enough, there can be no liability unless the accountant used words or conduct “directly expressed to the claimant,” which establish the accountant’s understanding of the claimant’s intended reliance on his work. E. Dickerson & Son v. Ernst & Young, 361 N.J. Super. 362, 368 (App. Div. 2003), *aff’d* 179 N.J. 500 (2004) *citing* N.J.S.A. § 2A:53A-25(b)(2)(c).

<sup>13</sup> N.J.S.A. § 2A:53A-25(b).

negligence claims.<sup>14</sup> An accountant is not liable to surety for negligence in review of unaudited statements when the opinion is disclaimed.<sup>15</sup>

## **5. Derivative/Direct Claims**

New Jersey generally recognizes shareholder derivative actions and permits a shareholder to bring a professional liability action against wrongdoers on behalf of a corporation to force the wrongdoers to compensate the corporation for the injury caused.<sup>16</sup> However, individual claims cannot be asserted based upon a shareholder's general reliance upon annual audits to satisfy the Act's statutory conditions for liability for accounting negligence claims by non-clients.<sup>17</sup> As derivative claims are considered to be brought on behalf of the corporation, derivative accounting negligence claims brought against the corporation's accountant are likely sustainable under New Jersey law.<sup>18</sup>

### **C. Liability/Breach of Duty**

#### **1. General Standard of Care**

Under the standard of care applicable in New Jersey, accountants are generally required to perform the services for which they were engaged in good faith and with reasonable care and competence, and are liable for damages occasioned by any failure to perform services in such a manner.<sup>19</sup> Further, accountants have the professional obligation to perform their services subject to a standard of care commensurate with the skill and knowledge normally possessed by members

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<sup>14</sup> Id. at 480.

<sup>15</sup> First Indem. of America Ins. Co. v. Letters, Meyler & Co., P.C., 326 N.J. Super. 366 (Law Div. 1998), aff'd o.b. 326 N.J. Super. 233 (App. Div. 1999).

<sup>16</sup> "[A] shareholder derivative action permits a shareholder to bring suit against wrongdoers on behalf of the corporation, and it forces those wrongdoers to compensate the corporation for the injury they have caused." In re PSE & G Shareholder Litigation, 173 N.J. 258, 277 (quoting Bradley T. Ferrell, Note, A Hybrid Approach: Integrating the Delaware and the ALI Approaches to Shareholder Derivative Litigation, 60 Ohio St. L.J. 241 (1999)); see also Schulman v. Wolff & Samson, PC, 401 N.J. Super. 467, 479 (App. Div. 2008)(allowing shareholder derivative claim against law firm).

<sup>17</sup> "General reliance by these individual corporate stockholders . . . on annual audits was not sufficient to satisfy the statutory conditions for liability and confer a cause of action for accounting negligence." E. Dickerson & Son, Inc. v. Ernst & Young, LLP, 179 N.J. 500, 506 (N.J. 2004)(citing In re PSE & G Shareholder Litigation, 173 N.J. 258 (2002)).

<sup>18</sup> See E. Dickerson & Son, Inc. v. Ernst & Young, LLP, 179 N.J. 500, 506 (2004)(contemplating the permissibility under the Act of shareholder derivative accounting negligence claims, as such claims are considered to be brought on behalf of the corporation)

<sup>19</sup> Levine v. Wiss & Co., 97 N.J. 242, 248 (N.J. 1984).

of their profession in good standing.<sup>20</sup>

**a. Role of GAAS (and whether incorporated into state law)**

Auditors engaged to conduct their audits in accordance with GAAS have a duty to exercise due care in obtaining reasonable assurances that the company's financial statements are free of material misstatements. If the auditor fails to exercise such care, it shall be made answerable for such failure.<sup>21</sup> An auditor's professional duty to its corporate client requires the auditor to comply with GAAS and GAAP, which are designed, at least in part, to detect fraudulent activity and accountants can be required to answer to claims when they fail to detect fraud that a reasonably prudent auditor acting within the scope of its engagement would uncover.<sup>22</sup>

**i. Audits based on sampling and testing**

GAAS may require an accountant performing an audit to examine a sample of contracts and trace the unearned portion of those contracts to the deferred revenue contracts to ensure that they were recorded as liabilities rather than revenues.<sup>23</sup>

**ii. Reliance on internal controls**

No New Jersey cases located.

**iii. Auditors not guarantors**

The New Jersey Supreme Court's decision to allow claims based upon an auditor's failures to detect fraud in NCP Litig. Trust v. KPMG LLP was criticized by the dissent as moving too far in the direction of expanding "the liability of auditors to the point where they become guarantors."<sup>24</sup> However, the majority's decision remains the binding law in New Jersey.

**iv. Limited ability to uncover fraud/Statement of Auditing Standard No. 99 – Consideration of Fraud**

No New Jersey cases located.

**v. Professional judgment**

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<sup>20</sup> Id. at 246. (citing Restatement (Second) of Torts § 299A (1965)).

<sup>21</sup> NCP Litig. Trust v. KPMG, 399 N.J. Super. 606, 625-626 (Law Div. 2007) (on remand).

<sup>22</sup> NCP Litig. Trust v. KPMG LLP, 187 N.J. 353, 380 (N.J. 2006).

<sup>23</sup> Id. at 613-614.

<sup>24</sup> NCP Litig. Trust v. KPMG LLP, 187 N.J. 353, 406, (N.J. 2006)(J. Rivera-Soto, *dissenting*)

No New Jersey cases located.

**b. Internal firm guidance (extent to which it may or may not set a standard or be admissible as evidence of GAAS)**

It has been reasoned that an accounting firm’s “internal policies – standing alone – cannot demonstrate the applicable standard of care,” however the issue remains unresolved.<sup>25</sup> If auditors were exposed to heightened liability for developing and promulgating training materials or internal policies that provided for a higher standard of care than GAAS, it would discourage accounting firms from training professionals to exceed minimum standards and create a patchwork quilt of standards of care for each accounting firm depending upon its own internal standards.<sup>26</sup>

**c. Other standards (statutory, GAGAS, etc.)**

Generally accepted accounting principles (GAAP) are considered to be defined by pronouncements issued by the Financial Accounting Standards Board (FASB) and its predecessor and successor entities and similar pronouncements issued by other entities having similar general recognized authority.<sup>27</sup>

An accounting firm shall not permitted to issue financial statements to imply that he or she is acting as an independent public accountant with respect to such financial statements unless the licensee has complied with applicable generally accepted auditing standards (GAAS) and, if applicable, generally accepted governmental auditing standards (GAGAS). Statements on Auditing Standards (SAS) issued by the American Institute of Certified Public Accountants (AICPA), and the Public Company Accounting Oversight Board (PCAOB), and other pronouncements having similar generally recognized authority, are considered to be interpretations of generally accepted auditing standards, and departures therefrom shall be justified by those who do not follow them.<sup>28</sup>

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<sup>25</sup> Cast Art Indus., LLC v. KPMG LLP, 416 N.J. Super. 76, 106 (App. Div. 2010) rev’d on other grounds by 209 N.J. 208 (2012) *citing* Briggs v. Wash. Metro. Area Transit Auth., 481 F.3d 839, 848 (D.C. Cir. 2007). Defendant argued to the Supreme Court of New Jersey that the jury should not have been allowed to consider the training materials in determining whether they departed from the GAAS. The Supreme Court regarded that argument as moot and that it need not be addressed. The matter was remanded to the trial court for entry of a judgment of dismissal.

<sup>26</sup> See Cast Art Indus., LLC v. KPMG LLP, 416 N.J. Super. 76, 106 (App. Div. 2010). Although the New Jersey Appellate Division’s discussions and reasoning amounts to dicta in a case that was overturned on other grounds the reasoning has been relied upon and cited by a Pennsylvania Federal District Court. See Terry v. McNeil-PPC, Inc. (In re Tylenol Acetaminophen Mktg.), 2016 U.S. Dist. LEXIS 26603, \*25 (E.D. Pa. Mar. 2, 2016)

<sup>27</sup> N.J.A.C. 13:29-3.6(b).

<sup>28</sup> N.J.A.C. § 13:29-3.5.

d. **Role of professional standards applicable to non-audit engagements (e.g., reviews, compilations, agreed-upon procedures, expert witness role, etc.)**

Accountants serving as expert witnesses in New Jersey may be subject to liability based upon the failure to perform appropriate due diligence in connection with the service as expert witnesses.<sup>29</sup> Liability may result from failure to appropriately address conflict of interest issues in non-audit engagements.<sup>30</sup> An accountant engaged in performing services as independent auditor required to exercise normal professional skill and care.<sup>31</sup>

e. **Role of ethical standards applicable to all engagements.**

The New Jersey Society of Certified Public Accountant (Society) relies upon the rules of professional conduct of the American Institute of CPAs. Accountants licensed by the New Jersey State Board of Accountancy, are also required to comply with the Board's Rules of Professional Conduct, which, in some cases, may differ from the Society's Code.<sup>32</sup>

**2. Locality Rule**

While New Jersey courts have not discussed the “locality rule” with respect to accountant malpractice actions, they have abandoned the rule in other fields and generally hold professionals to a national standard of care.<sup>33</sup>

**3. Specialization**

New Jersey Courts have not addressed specialization in the context of the standard of care applicable to accountants, but as the standard of care directly references “the skill and knowledge normally possessed by members of their profession in good standing” it appears that standard of care does not include a specialization requirement New Jersey.<sup>34</sup>

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<sup>29</sup> EisnerAmper LLP v. Morgan, 2011 N.J. Super. Unpub. LEXIS 807, \*11-12 (Ch.Div. Mar. 11, 2011)(discussing potential liability resulting from non-disclosure of merger between accounting firms which created a conflict between the experts in a matrimonial matter).

<sup>30</sup> Ibid.

<sup>31</sup> Rosenblum v. Adler, 93 N.J. 324, 344 (1983)

<sup>32</sup> N.J.A.C. § 13:29-3.5.

<sup>33</sup> See Jedel v. Tapper, 13 N.J. Misc. 809, 181 A. 400 (Sup. Ct. 1935); Galvin v. Mizuho Med. Corp., 2008 N.J. Super. Unpub. LEXIS 659, \*15-16, 2008 WL 4791023 (App.Div. Nov. 5, 2008).

<sup>34</sup> In re Application of New Jersey Soc. of Certified Public Accountants, 102 N.J. 231, 242, \*19-20 (N.J. 1986) (Stating that the professional obligation of accountants is to perform their services subject to a standard of care commensurate with the skill and knowledge normally possessed by members of their profession in good standing)..

## **D. Causation**

### **1. “But For”/Reliance**

Under New Jersey law, a plaintiff must prove causation-in-fact, which is, the “reasonable connection between the act or omission of the defendant and the damages which the plaintiff has suffered.”<sup>35</sup>

### **2. Legal/Proximate Causation**

In New Jersey, to establish the required causal connection between a defendant’s negligence and plaintiff’s harm, plaintiff must present evidence to support a finding that defendant’s negligent conduct was a substantial factor in bringing about plaintiff’s injury, even though there may be other concurrent causes of the harm.<sup>36</sup> The burden of proving the causal relationship rests with the client and cannot be satisfied by “mere conjecture, surmise or suspicion.”<sup>37</sup> As discussed above, New Jersey has adopted a restrictive test under the Act to address foreseeability and the determination of when an auditor may be held liable by someone consulting their report. See Sec. B ¶ 4, infra.<sup>38</sup>

## **E. Damages**

### **1. Actual Damages**

Under New Jersey law a plaintiff must establish that he or she sustained actual, as opposed to merely speculative damages.<sup>39</sup>

### **2. “Deepening Insolvency”**

New Jersey courts recognize the theory of “deepening insolvency” as a legally cognizable harm.<sup>40</sup> An insolvent corporation suffers harm when a defendant either fraudulently or negligently, artificially prolongs, or contributes to the artificial prolongation of, the corporation’s life, thereby increasing the corporation’s debt and exposure to creditors, and depleting its assets.<sup>41</sup> Deepening insolvency operates as the practical means for holding auditor’s accountable for their negligence.<sup>42</sup>

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<sup>35</sup> Shackil v. Lederle Labs., 116 N.J. 155, 162, 561 A.2d 511 (1989) (discussing medical malpractice)(quoting W. Keeton, D. Dobbs, R. Keeton & D. Owen, Prosser & Keeton on the Law of Torts § 41 at 263 (5th ed. 1984)).

<sup>36</sup> Froom v. Perel, 377 N.J. Super. 298, 313 (App. Div. 2005)(discussing legal malpractice).

<sup>37</sup> Sommers v. McKinney, 287 N.J. Super. 1, 10 (App.Div. 1996)(discussing legal malpractice).

<sup>38</sup> Cast Art Industries, LLC v. KPMG LLP, 209 N.J. 208, 218 (2012).

<sup>39</sup> Olds v. Donnelly, 150 N.J. 424, 437, 696 A.2d 633 (1997).

<sup>40</sup> NCP Litig. Trust v. KPMG, 399 N.J. Super. at 618.

<sup>41</sup> Id. at 619.

<sup>42</sup> Id. at 627.

Corporate damage in the form of increased liabilities, decrease in fair asset value, and lost profits encompasses the same concept as deepening insolvency. Whether courts term it “deepening insolvency” or describe in detail the gamut of destruction that the term is meant to embrace, the bottom line is the same. Harm is harm. Where there is a harm, the law provides a remedy.<sup>43</sup>

### **3. Punitive Damages**

To obtain punitive damages in New Jersey generally, a plaintiff must establish that the defendant acted not only intentionally, but did so in the sense of an evil-minded act or an act accompanied by a wanton and willful disregard of the rights of plaintiffs.<sup>44</sup> What is required is a positive element of conscious wrongdoing.<sup>45</sup>

### **4. Attorneys Fees**

New Jersey generally follows the “American Rule” which does not permit a prevailing party to recover attorney’s fees and costs at the conclusion of a case.<sup>46</sup> It should be noted that New Jersey is one of the few jurisdictions that holds a negligent *attorney* responsible for the reasonable legal expenses and attorney fees incurred by a former client in prosecuting the legal malpractice action, as consequential damages that are proximately related to the malpractice by the attorney.<sup>47</sup> This line of cases is specifically limited to legal malpractice cases and similar logic does not apply to accounting malpractice claims in New Jersey where the American rule applies.

## **F. Defenses**

### **1. Statutes of Limitations**

Under New Jersey law, an action for accounting malpractice shall be filed six (6) years from the date that it accrues.<sup>48</sup> Legislation to shorten the statute of limitations to two (2) years is pending.<sup>49</sup>

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<sup>43</sup> *Id.* at 625.

<sup>44</sup> *Nappe v. Anshelewitz, Barr, Ansell & Bonello*, 97 N.J. 37, 49 (1984)

<sup>45</sup> *Berg v. Reaction Motors Div.*, 37 N.J. 396, 414 (1962).

<sup>46</sup> *Occhifinto v. Olivo Constr. Co.*, 221 N.J. 443, 449 (2015) (quoting *Walker v. Giuffre*, 209 N.J. 124, 127 (2012)).

<sup>47</sup> *Saffer v. Willoughby*, 143 N.J. 256, 272 (N.J. 1996).

<sup>48</sup> *NCP Litig. Trust v. KPMG*, 399 N.J. Super. 606, 627 (Law Div. 2007) *citing* N.J.S.A. § 2A:14-1

<sup>49</sup> Bill A1254

**a. Accrual**

**i. Date of work**

Although not stated in terms of the accrual of the statute of limitations, the Act bars negligence claims where the accountant did know or agree “at the time of the engagement” that the his or her accounting services would be made available to claimant.<sup>50</sup>

**ii. Discovery Rule**

Traditionally, a claim “accrues” when the plaintiff suffers consequential damages or a loss from the defendant’s actions. The courts have adopted a “discovery rule” to take into account the fact that some plaintiffs may not be aware that they have suffered a loss. The discovery rule provides that a cause of action only accrues when the plaintiff becomes aware, or reasonably should become aware, that he has suffered a harm.<sup>51</sup> Thus, a cause of action in an accounting malpractice case accrues when facts are established which reveal that a client knew or should have known that injury occurred, and that the injury was the fault of the accountant.<sup>52</sup>

**iii. Continuous representation**

New Jersey courts have reasoned that claims against attorneys or doctors do not accrue until the representation or treatment has ceased in order to protect the clients and patients from potential misrepresentations regarding fault.<sup>53</sup> No New Jersey Court has addressed the continuous representation doctrine in the context of an accounting malpractice claim.

**iv. Other**

No New Jersey cases found.

**b. Tolling**

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<sup>50</sup> N.J.S.A. 2A:53A-25

<sup>51</sup> NCP Litig. Trust v. KPMG, 399 N.J. Super. 606, 627 (Law Div. 2007) *citing* Diamond v. N.J. Bell Tel. Co., 51 N.J. 594, 596-597 (1968).

<sup>52</sup> Circle Chevrolet Co. v. Giordano, Halleran & Ciesla, 274 N.J. Super. 405, 414-415, (App.Div. 1994).

<sup>53</sup> Grunwald v. Bronkesh, 131 N.J. 483, 498-499 (N.J. 1993); Lynch v. Rubacky, 85 N.J. 65, 75 (1981).

### **i. Ongoing litigation**

New Jersey courts generally will not toll the statute of limitations while the client contests the underlying injury through litigation.<sup>54</sup>

### **ii. Fraudulent concealment**

New Jersey does not recognize a separate doctrine with respect to tolling the statute of limitations in cases of fraudulent concealment, but such issues may be relevant to courts equitable tolling power. See below.

### **iii. Other (Equitable Tolling)**

New Jersey courts may apply equitable tolling of the statute of limitation in three circumstances: (1) where the complainant has been induced or tricked by the adverse party's misconduct into allowing the filing deadline to pass; (2) where a plaintiff has in some extraordinary way been prevented from asserting legal rights; and (3) where a plaintiff has timely asserted rights mistakenly by either defective pleading or in the wrong forum.<sup>55</sup>

## **2. Imputation of Client Knowledge/Conduct (*In Pari Delicto*/the *Wagoner Rule*)**

In New Jersey, the imputation defense is unavailable where innocent shareholders are injured by auditor's negligence. The imputation doctrine is based on the presumption that the agent has discharged his duty to disclose to his principal all material information which the agent obtained through the course of his agency. However, the presumption dissolves when the agent is engaged in acts that are entirely adverse to his principal.<sup>56</sup>

The presence of auditor negligence arguably could be called an exception to the imputation doctrine. The court may consider negligence to be both an exception to the imputation doctrine and a ground for estoppel.<sup>57</sup>

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<sup>54</sup> Dinizo v. Butler, 315 N.J. Super. 317, 322 (App.Div. 1998); (citing Grunwald v. Bronkesh, 131 N.J. 483, 496-97 (1993))(holding that the statute of limitations was not tolled were legal malpractice accrued during the pendency of an underlying action brought by the client against third parties).

<sup>55</sup> Binder v. Price Waterhouse & Co., L.L.P., 393 N.J. Super. 304, 312, (App.Div. 2007)(disallowing the equitable tolling of accounting malpractice claims because delay was based upon plaintiff's inaction).

<sup>56</sup> NCP Litig. Trust v. KPMG, 399 N.J. Super. at 630. The Court explained that the Supreme Court's opinion was that Defendant's own alleged negligence estopped them from raising the imputation doctrine as a defense against innocent shareholders. Id. at 631.

<sup>57</sup> Id. at 631-632. The Court held "Thus, it is not 'imputation' per se that revulsed our Supreme Court, but its context, specifically as a total and complete bar to recovery against a negligent auditor under the doctrine of *in pari delicto*."

### 3. **Contributory and Comparative Fault (including audit interference rule)**

New Jersey follows a comparative negligence standard.<sup>58</sup> The application of comparative negligence in the accountant liability area is intended to give corporations and shareholders good reason to actively supervise managers while simultaneously encouraging auditors to carefully monitor the transactions of the corporation to ensure that auditors are only liable for as much the alleged losses as are directly attributable and proportionate to the auditor's negligence.<sup>59</sup> However, accountants are precluded from raising the comparative/contributory negligence of the FDIC in claims asserted against them by the FDIC, on behalf of a failed bank.<sup>60</sup>

### 4. **Lack of Justifiable Reliance**

New Jersey does not follow the Restatement (Second) of Torts 552(1) which states “[o]ne who, in the course of his business, profession or employment ... supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.”<sup>61</sup>

### 5. **Assumption of Risk**

New Jersey generally recognizes assumption of the risk as an affirmative defense to an established duty.<sup>62</sup> As distinguished from a general defense, an affirmative defense is considered waived if not pleaded or otherwise timely raised.<sup>63</sup> No New Jersey cases address assumption of the risk in the context of an accountant negligence claim. Assumption of the risk is most commonly asserted in personal injury actions and would likely have no applicability in a

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<sup>58</sup> NCP Litig. Trust v. KPMG LLP, 187 N.J. 353, 380 (2006) *citing* N.J.S.A. § 2A:15-5.1.

<sup>59</sup> Ibid.

<sup>60</sup> Resolution Trust Corp. v. Moskowitz, 1994 U.S. Dist. LEXIS 7114, \*60 (D.N.J. May 24, 1994).

<sup>61</sup> Cast Art Indus., LLC v. KPMG LLP, 209 N.J. 208, 219-220 (2012).

<sup>62</sup> Tevrow v. Arowolo, 2015 N.J. Super. Unpub. LEXIS 2082, \*25 (App.Div. Aug. 27, 2015) *citing* Meistrich v. Casino Arena Attractions, Inc., 31 N.J. 44, 48-49, (1959) (explaining where assumption of risk is asserted as an affirmative defense, it is a defense "to an established breach of duty).

<sup>63</sup> Pearlstein v. Leeds, 52 N.J. Super. 450, 456 (App. Div. 1958).

professional liability context and any potential related concepts would be addressed as contributory negligence.<sup>64</sup>

## **6. Mitigation of Damages and Avoidance of Loss**

New Jersey recognizes the doctrine of mitigation of damages and the principle that a professional liability claimant should not be entitled to damages that reasonably could have been avoided.<sup>65</sup> The application of the duty to mitigate is a factual question and inappropriate for resolution on summary judgment.<sup>66</sup> Prior to the enactment of the Act, a New Jersey District court reasoned that accounting malpractice defendants should be permitted to come forward with mitigation evidence that the innocent party received some benefit from the alleged wrongdoing to avoid a possible windfall to the claimant.<sup>67</sup>

## **7. Client Indemnification Agreements**

No New Jersey cases found.

## **G. Procedural Issues**

### **1. Special Pleading Requirements**

#### **a. Verification / b. Expert Report (Affidavit of Merit)**

In New Jersey, an accounting negligence plaintiff must comply with New Jersey's Affidavit of Merit Statute ("AOM Statute").<sup>68</sup> The New Jersey legislature enacted the AOM Statute in connection with a tort reform package intended to balance the right to sue with controlling unwarranted nuisance suits.<sup>69</sup> The AOM Statute requires that a plaintiff filing "any action for damages for personal injuries, wrongful death or property damage resulting from an alleged act of malpractice or negligence by a licensed professional" provide the defendant with

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<sup>64</sup> Resolution Trust Corp. v. Moskowitz, 1994 U.S. Dist. LEXIS 7114, \*44 (D.N.J. May 24, 1994)(stating that the assumption of the risk affirmative defense would have little or no consequence in a suit contending the former directors and officers and others were liable for the bank's insolvency).

<sup>65</sup> Nix v. Verp, 2011 N.J. Super. Unpub. LEXIS 379, \*17-18, 2011 WL 557947 (App.Div. Feb. 18, 2011) citing Covino v. Peck, 233 N.J. Super. 612, 617 (App. Div. 1989)(holding a duty to mitigate applies to legal malpractice claims).

<sup>66</sup> . Prospect Rehab. Servs., Inc. v. Squitieri, 392 N.J. Super. 157, 168-69, (App. Div.), certif. denied, 192 N.J. 293 (2007).

<sup>67</sup> Ronson v. Talesnick, 33 F. Supp. 2d 347, 356, 1999 U.S. Dist. LEXIS 402, \*25, 43 Fed. R. Serv. 3d (Callaghan) 601 (D.N.J. 1999)

<sup>68</sup> N.J.S.A. § 2A:53A-27 et. seq.

<sup>69</sup> Palanque v. Lambert-Woolley, 168 N.J. 398, 774 A.2d 501, 505 (N.J. 2001)

“an affidavit of an appropriate licensed person [stating] that there exists a reasonable probability that the care, skill or knowledge exercised or exhibited in the treatment, practice or work that is the subject of the complaint, fell outside acceptable professional or occupational standards or treatment practices.”<sup>70</sup>

Under the plain language of the AOM Statute a “subspecialty requirement” applies specifically to medical malpractice claims. With respect to other licensed professionals, the statute requires that “the person executing the affidavit shall be licensed in this or any other state; have particular expertise in the general area or specialty involved in the action, as evidenced by board certification or by devotion of the person’s practice substantially to the general area or specialty involved in the action for a period of at least five years.” While some uncertainty remains as to specialty issue, whether the AOM affiant must practice in the same specialty as the defendant will generally be decided on a case-by-case basis and requires an examination by the Court of whether the allegations in the complaint overlap between the practices of the affiant and the defendant, or whether the allegations arise from the defendant’s deviation from accepted standards of care that apply to the particular specialty of the defendant.<sup>71</sup>

The affidavit must be provided within 60 days after the defendant files its answer. For good cause shown (although generally granted without issue), the AOM Statute provides for one extension period of an additional 60 days contiguous to the initial 60-day period. Under the AOM Statute, the failure to file an appropriate affidavit within the statutory time limits may result in dismissal of even a meritorious cases. To limit the flow of dismissal motions based on claims of non-compliance with the statute, the New Jersey Supreme Court required for all professional malpractice cases that “a case management conference be held within ninety days of the service of an answer” at which the professional defendant would raise “any objections to the adequacy of the affidavit” served by the plaintiff.<sup>72</sup> At the so called “Ferreria conference”, if the court determines that an affidavit is deficient, the plaintiff will still have until the end of the 120-day extended time period to conform the affidavit to the requirements of the AOM Statute.<sup>73</sup> A limited exception to the AOM requirement exists in certain “common knowledge” cases.<sup>74</sup>

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<sup>70</sup> N.J.S.A. 2A:53A-26 -29.

<sup>71</sup> Dipasquale v. Indus. Urban Corp., 2016 N.J. Super. Unpub. LEXIS 426, \*16 (Law Div. Feb. 19, 2016)(holding a AOM of an attorney with no bankruptcy experience invalid in connection with a legal malpractice actions arising from representation in a bankruptcy matter).

<sup>72</sup> Ferreira v. Rancocas Orthopedic Assocs., 178 N.J. 144, 154 (N.J. 2003); see also Paragon Contractors, Inc. v. Peachtree Condo. Ass'n, 202 N.J. 415, 421 (2010).

<sup>73</sup> Buck v. Henry, 207 N.J. 377, 389, (N.J. 2011)

<sup>74</sup> Hubbard v. Reed, 168 N.J. 387, 394 (N.J. 2001)

**b. Enforceability of arbitration and limitation of liability clauses from engagement letter**

In New Jersey, arbitration is a favored means of dispute resolution and in reviewing arbitration clauses, courts will respect the intentions of the parties and rely upon “basic contract principles.”<sup>75</sup> However, accounting malpractice claims are not subject to arbitration where the accountant is not a party to the underlying agreement to arbitrate, even where the claims against the accountant are substantially intertwined with the claims between the parties to the express arbitration agreement.<sup>76</sup>

**2. Burdens of Proof**

In New Jersey, a professional liability plaintiff bears the burden of establishing by a preponderance of competent credible evidence that injuries were suffered as a proximate consequence of the breach of an owed duty and this burden is not satisfied conjecture, surmise or suspicion.<sup>77</sup> Under New Jersey law, allegations of fraud must be pled “with the particulars of the wrong, with dates and items if necessary, shall be stated insofar as practicable.”<sup>78</sup>

**3. Expert Testimony Requirements**

**a. Standard of Care**

With regard to accounting negligence claims, expert testimony is required to establish a deviation from a professional standard of care.<sup>79</sup> In limited circumstances, the common knowledge exception may apply to allow claims against licensed professionals to proceed without the assistance of expert testimony.<sup>80</sup>

**c. Causation**

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<sup>75</sup> EPIX Holdings Corp. v. Marsh & McLennan Cos., 410 N.J. Super. 453, 471 (App. Div. 2009); Bruno v. Mark MaGrann Assocs., 388 N.J. Super. 539, 545 (App. Div. 2006); Alamo Rent A Car, Inc. v. Galarza, 306 N.J. Super 384, 390-91 (App. Div. 1997).

<sup>76</sup> Hirsch v. Amper Financial Services, LLC, 215 N.J. 174, 196, (N.J. 2013).

<sup>77</sup> Sommers v. McKinney, 287 N.J. Super. 1, 4, (App.Div. 1996)

<sup>78</sup> R. 4:5-8.

<sup>79</sup> Accord Nuveen Mun. Trust v. Withumsmith & Brown, P.C., 2009 U.S. Dist. LEXIS 93645, 2009 WL 3246139, \*3 (D.N.J. Oct. 7, 2009).

<sup>80</sup> Hubbard v. Reed, 168 N.J. 387, 394 (N.J. 2001); Davis v. Pine Acres Convalescent Ctr., 2015 N.J. Super. Unpub. LEXIS 2380, \*8 (App.Div. Oct. 19, 2015)

In New Jersey, expert testimony is required to establish that the licensed professional's alleged malpractice was the proximate cause of the damaged to the plaintiff.<sup>81</sup> In the limited circumstance where the causal relationship between professional negligence and the client's loss is so obvious that the trier of fact can resolve the issue as a matter of common knowledge, expert testimony will not be required.<sup>82</sup>

#### **4. The defendant class and professional partnerships**

No New Jersey cases located.

#### **5. Accountant-client privilege/client confidentiality obligations**

There is no accountant-client privilege under New Jersey common law, however accountants are statutorily precluded from disclosing client information without consent, except as required by a Court proceeding or in connection with the preparation of financial statements.<sup>83</sup>

### **H. Alternative Causes of Action**

In New Jersey, professional liability claims will be considered as such irrespective of how the claims are pled by the plaintiff.<sup>84</sup> When presented with a tort or contract claim asserted against a licensed professional, rather than focusing on whether the claim is denominated as tort or contract, New Jersey courts will determine if the claim's underlying factual allegations require proof of a deviation from the professional standard of care applicable to that specific profession.<sup>85</sup>

#### **1. Breach of Contract**

In New Jersey, the elements of a claim for breach of contract are: (1) the existence of a valid contract between the parties; (2) the plaintiff adhered to his or her obligations under the

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<sup>81</sup> Vort v. Hollander, 257 N.J. Super. 56, 61 (App. Div.) (certif. denied, 130 N.J. 599 (1992)); Tietjen v. Mazawey, 2012 N.J. Super. Unpub. LEXIS 72, \*16, 2012 WL 86934 (App.Div. Jan. 12, 2012)

<sup>82</sup> Sommers v. McKinney, 287 N.J. Super. 1, 11, (App.Div.1996); Kranz v. Tiger, 390 N.J. Super. 135, 147-148, (App.Div. 2007).

<sup>83</sup> N.J.S.A., 45:2B-65

<sup>84</sup> Levinson v. D'Alfonso & Stein, 320 N.J. Super. 312, 315 (App. Div. 1999)(dismissing fraud claims against an attorney); see also Portes v. Tan, 2014 N.J. Super. Unpub. LEXIS 224, \*27 (App. Div. Feb. 6, 2014)

<sup>85</sup> Couri v. Gardner, 173 N.J. 328, 340 (2002); see also Charles A. Manganaro Consulting Eng'rs, Inc. v. Carneys Point Twp. Sewerage Auth., 344 N.J. Super. 343, 349 (App. Div. 2001), (stating "[w]hen the essential factual allegations upon which [a plaintiff's claim] rests are that the defendants' performance of the professional work . . . fell short . . . the claim is one for professional malpractice, even if the plaintiff denominates it as a claim for breach of contract.")

contract; (3) the defendant did not adhere to his or her obligations under the contract; and (4) damages arising out of defendant's failure to adhere to his or her obligations under the contract.<sup>86</sup>

## 2. Negligent Misrepresentation

New Jersey recognizes claims for Negligent Misrepresentation. The elements of such a claim require proof of an incorrect statement, negligently made and justifiably relied upon and such a claim may be the basis for recovery of damages for economic loss sustained as a consequence of that reliance.<sup>87</sup> In order to sustain a cause of action based on negligent misrepresentation, the plaintiff must establish that the defendant negligently made an incorrect statement of a past or existing fact, that the plaintiff justifiably relied on it and that his or her reliance caused a loss or injury.<sup>88</sup>

## 3. Fraud

The New Jersey Accountant Liability Act applies to actions for negligence and does not shield accountants from intentional acts of common law fraud or intentional acts which assist a client in committing a fraud or conspiratorial cooperation aimed at perpetration of a fraud.<sup>89</sup> Under New Jersey law, allegations of fraud must be pled "with the particulars of the wrong, with dates and items if necessary, shall be stated insofar as practicable."<sup>90</sup> New Jersey has an expansive consumer protection statute, the New Jersey Consumer Fraud Act, but such claims do not apply to licensed professionals.<sup>91</sup>

## 4. Breach of Fiduciary Duty (Effect of Auditor Independence Rules)

New Jersey generally recognizes claims for the breach of a fiduciary duty where one party places trust and confidence in another who is in a dominant or superior position and damages result from the breach of that relationship.<sup>92</sup>

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<sup>86</sup> Murphy v. Implicito, 392 N.J. Super. 245, 265 (App. Div. 2007); see also Model Civil Jury Charge 4.10A.

<sup>87</sup> 25 Enter. Ave., LLC v. 2001, Inc., 2015 N.J. Super. Unpub. LEXIS 832 (2015) *citing* H. Rosenblum, Inc. v. Adler, 93 N.J. 324, 334 (1983) superseded on other grounds, N.J.S.A. 2A:53A-25.

<sup>88</sup> 25 Enter. Ave., LLC v. 2001, Inc., 2015 N.J. Super. Unpub. LEXIS 832 (2015) *citing* Kaufman v. I-Stat Corp., 165 N.J. 94 (2000).

<sup>89</sup> State Dep't of Treasury, Div. of Inv. ex rel. McCormac v. Qwest Communications Intern., Inc., 387 N.J. Super. at 480.

<sup>90</sup> R. 4:5-8.

<sup>91</sup> Macedo v. Dello Russo, 178 N.J. 340, 346 (2004) (transactions that involve services provided by "learned professionals" have been deemed to fall outside the scope of the New Jersey Consumer Fraud Act); see also Vort v. Hollander, 257 N.J. Super. 56, 62 (App. Div. 1992), cert. denied, 130 N.J. 599 (1992),

<sup>92</sup> McKelvey v. Pierce, 173 N.J. 26, 57 (2002); Munoz v. Perla, 2011 N.J. Super. Unpub. LEXIS 3096, \*25, 2011 WL 6341182 (App.Div. Dec. 20, 2011)

New Jersey recognizes a claim for breach of fiduciary duty against accounts in instances arising from conflict of interest in connection with the service as an expert.<sup>93</sup> There is no case law in New Jersey specifically addressing breach of the fiduciary duty as related to auditor independence, but such a duty would likely not apply.

### **5. Aiding and Abetting (e.g., client's breach of fiduciary duty)**

Aiding and abetting fraud is a cognizable cause of action under New Jersey law.<sup>94</sup> A conspiracy to defraud requires compliance with the heightened pleading standard for fraud claims.<sup>95</sup>

### **6. Conspiracy**

The necessary proofs must show a combination of two or more persons acting in concert to commit an unlawful act, or to commit a lawful act by unlawful means, the principal element of which is an agreement between the parties to inflict a wrong against or injury upon another, and an overt act that results in damage.

For liability purposes, it is enough to if the person understands the general objectives of the scheme, accepts them, and agrees, either explicitly or implicitly, to do their part to further them. The gist of the claim is not the unlawful agreement but the underlying wrong which, absent the conspiracy, would give a right of action.<sup>96</sup>

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<sup>93</sup>EisnerAmper LLP v. Morgan, 2011 N.J. Super. Unpub. LEXIS 807, \*4 (Ch.Div. Mar. 11, 2011)

<sup>94</sup> Id.

<sup>95</sup> Tanner v. iPacesetters, LLC, 2015 N.J. Super. Unpub. LEXIS 809, \*17 (Law Div. Apr. 9, 2015)

<sup>96</sup> State Dep't of Treasury, Div. of Inv. ex rel. McCormac v. Qwest Communications Intern., Inc., 387 N.J. Super. at 486 (App. Div. 2006) (citations omitted).

## 7. State Securities Violations

New Jersey law recognizes a civil cause of action for control-person liability in fraudulent stock sales under the New Jersey Securities Act.<sup>97</sup> However, this statute applies only to a defendant who “offers, sells, or purchases” securities or “engages in the business of advising others . . . as to the value of securities.”<sup>98</sup> It has been determined that a buyer does not purchase a security from a lawyer or an accountant and that the claims under the New Jersey Securities Act cannot be maintained against accountants or lawyers.<sup>99</sup>

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<sup>97</sup> N.J.S.A. 49:3-71(e)

<sup>98</sup> N.J.S.A. 49:3-71(a)(5)

<sup>99</sup> Zendell v. Newport Oil Corp., 226 N.J. Super. 431, 440 (App. Div. 1988) (noting that a “buyer does not, in any meaningful sense, ‘purchase the security from’ a lawyer or accountant); see also McKowan Lowe & Co., Ltd. v. Jasmine, Ltd., 2005 U.S. Dist. LEXIS 35546, \*18, 2005 WL 3500032 (D.N.J. Dec. 20, 2005)