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North Carolina Supreme Court Grants Discretionary Review of Decision Regarding Auditor Liability, Including Whether an Auditor May Owe Fiduciary Duties to its Client.

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In *CommScope Credit Union v. Butler & Burke, LLP*, Case No. 5P15, the North Carolina Supreme Court has granted a petition for discretionary review of a decision of the Court of Appeals holding that an independent auditor may owe fiduciary duties to its client.¹ The case also raises significant issues regarding the applicability of the defenses of contributory negligence and *in pari delicto* in accounting malpractice claims. The case has drawn substantial interest, with five amicus briefs being filed in support of the auditor.²

The Court of Appeals' Decision

CommScope, which is a credit union organized under North Carolina law, failed for over a decade to file mandatory informational tax returns with the Internal Revenue Service ("IRS"). After discovering this failure, the IRS assessed a substantial penalty against the credit union.

CommScope brought suit against the accounting firm that had served for many years as its independent auditor, asserting claims for breach of contract, negligence, professional malpractice, and breach of fiduciary duty. It alleged that the auditor breached its

professional duties by not requesting copies of the informational tax returns as part of the audit and by failing to discover that CommScope's General Manager had failed to file the returns. The auditor asserted a number of affirmative defenses, including contributory negligence and *in pari delicto*.

The trial court granted the auditor's motion to dismiss, holding that CommScope's complaint failed to state a claim on which relief could be granted.

The Court of Appeals, however, reversed the trial court and remanded the case for proceedings on the merits. That court first held that the allegations of the complaint, if true, established a fiduciary relationship between CommScope and the auditor. The Court of Appeals also held that neither contributory negligence nor *in pari delicto* supported dismissal of CommScope's complaint.³

Proceedings in the North Carolina Supreme Court

The auditor filed a petition for discretionary review with the North Carolina Supreme Court. On March

5, 2015, the Supreme Court granted the petition.⁴

In the Supreme Court, the auditor and all of the *amici* argue that the Court of Appeals' holding that an independent auditor may owe fiduciary duties to its client sets a dangerous precedent that, if upheld by the Supreme Court, would make North Carolina an outlier nationally and would interfere with auditors' ability to perform their job properly.

In particular, by allowing a breach of fiduciary duty claim to proceed on the facts alleged in CommScope's complaint, the Court of Appeals held, in effect, that every standard audit engagement in North Carolina may give rise to a fiduciary relationship. Critically, however, imposing fiduciary duties on an auditor cannot be reconciled with the independence and impartiality that are required of auditors under professional auditing standards and governing law. A fiduciary is obligated to act in the best interests of the party reposing confidence – a role that is antithetical to the duties of an auditor, who is required to maintain independence from her client in order to render an

unbiased opinion on the client's financial statements. For these reasons, the vast weight of authority nationally holds that auditors do not owe fiduciary duties to their clients.⁵ The auditor and *amici* argue that reversal is required to ensure that accountants can continue to perform independent audits in North Carolina as they do in other states, and to protect the public's ability to rely on audit reports for unbiased opinions.

Although the breach of fiduciary duty issue is the most significant to the profession nationally, the Court of Appeals' holdings on the contributory negligence and *in pari delicto* issues are also important. As to those issues, the auditor, supported by one of the amici,⁶ argue that the Court of Appeals' decision is contrary to well-established North Carolina law that a party cannot recover from others if the party's own fault, whether negligent or

intentional, is a proximate cause of the harm it suffered. Accepting all of the allegations of the complaint as true, which is required at the motion to dismiss stage, CommScope had a legal duty to file informational returns annually; breached that duty; and suffered damages as a result. Accordingly, the auditor argues, CommScope was at fault, and the doctrines of contributory negligence or *in pari delicto* therefore bar its recovery as a matter of law.

In the Court of Appeals, CommScope argued that North Carolina should adopt the audit interference rule. In the minority of states that have adopted that rule, the negligence of an audit client does not reduce (in a comparative negligence state) or preclude (in a contributory negligence state, such as North Carolina) recovery unless the client's negligence interfered with the auditor's ability to conduct the

audit. The North Carolina Supreme Court may weigh in on this important issue, as well.

Conclusion

The North Carolina Supreme Court's decision in this case could set an important precedent for accountants who perform independent audits, and therefore bears watching. Briefing is expected to be completed by the end of June 2015, with argument likely in the Fall of 2015 and a decision at some point thereafter. 🍀

Endnotes

- 1 *CommScope Credit Union v. Butler & Burke, LLP*, 764 S.E.2d 642 (N.C. Ct. App. 2014).
- 2 The following organizations filed amicus briefs in the North Carolina Supreme Court: (1) the Chamber of Commerce of the United States; (2) the North Carolina Chamber; (3) the National Association of State Boards of Accountancy; (4) the North Carolina Association of Certified Public Accountants, American Institute of Certified Public Accountants, and Center for Audit Quality; and (5) Cherry Bekaert, LLP, CliftonLarsonAllen, LLP and Dixon Hughes Goodman, LLP.
- 3 *CommScope*, 764 S.E.2d at 647-52.
- 4 *CommScope Credit Union v. Butler & Burke, LLP*, 768 S.E.2d 560 (N.C. 2015).
- 5 See, e.g., *Stewart v. Wilmington Trust SP Servs., Inc.*, No. CV 9306-VCP, --- A.3d ---, 2015 WL 1396382, at *16 (Del. Ch. Mar. 26, 2015) (“[I]n order properly to discharge its ‘watchdog’ function, the auditor must maintain total independence from the client at all times,” such that “[t]

he mere provision of audit services does not of itself convert an auditor into a fiduciary of the corporation.” (internal quotation marks omitted)); *Wright v. Sutton*, No. 1:08-cv-1431, 2011 WL 1232607, at *5 (S.D. W. Va. Mar. 29, 2011) (“In general, ‘an accountant hired to audit the financial statements of a client is not a fiduciary of the client, but rather is required to be independent of the client.’” (quoting *Strategic Capital Res., Inc. v. Citrin Cooperman & Co., LLP*, 213 F.App’x 842, 2007 WL 30836, at *1 (11th Cir. 2007)); *Resolution Trust Corp. v. KPMG Peat Marwick*, 844 F. Supp. 431, 436 (N.D. Ill. 1994) (in general, “the nature of the independent auditor precludes a finding of fiduciary duty”); *FDIC v. Schoenberger*, 781 F. Supp. 1155, 1157-58 (E.D. La. 1992) (“[A]ccountants do not owe a fiduciary duty to their clients when providing services as auditor; rather the nature of an independent auditor is that it will perform the services objectively and impartially.”).

- 6 The amicus brief of Cherry Bekaert, LLP, CliftonLarsonAllen, LLP and Dixon Hughes Goodman, LLP addressed both the fiduciary duty issue and the contributory negligence/*in pari delicto* issue. The other amicus briefs were limited to the fiduciary duty issue.