

Ultramares Corp. v Touche

255 N.Y. 170

Court of Appeals of New York

Decided January 6, 1931

ULTRAMARES CORPORATION, Appellant and Respondent, v. GEORGE A. TOUCHE et al., Copartners under the Firm Name of TOUCHE, NIVEN & COMPANY, Respondents and Appellants. CROSS-APPEALS from a judgment of the Appellate Division of the Supreme Court in the first judicial department, entered June 18, 1930. Herbert R. Limburg, Martin Conboy, David L. Podell, Joseph L. Weiner and Lionel S. Popkin for plaintiffs, appellants and respondents. Samuel Untermeyer, John W. Davis and James Marshall for defendants, respondents and appellants. Roger S. Baldwin, J. Harry Covington and Kenneth McEwen for American Institute of Accountants, amicus curiae.

CARDOZO, BENJAMIN, Ch. J.

The action is in tort for damages suffered through the misrepresentations of accountants, the first cause of action being for misrepresentations that were merely negligent and the second for misrepresentations charged to have been fraudulent.

In January, 1924, the defendants, a firm of public accountants, were employed by Fred Stern & Co., Inc., to prepare and certify a balance sheet exhibiting the condition of its business as of December 31, 1923. They had been employed at the end of each of the three years preceding to render a like service. Fred Stern & Co., Inc., which was in substance Stern himself, was engaged in the importation and sale of rubber. To finance its operations, it required extensive credit and borrowed large sums of money from banks and other lenders. All this was known to the defendants. The defendants knew also that in the usual course of business the balance sheet when certified would be exhibited by the Stern company to banks, creditors, stockholders, purchasers or sellers, according to the needs of the occasion, as the basis of financial dealings. Accordingly, when the balance sheet was made up, the defendants supplied the Stern company with thirty-two copies certified with serial numbers as counterpart originals. Nothing was said as to the persons to whom these counterparts would be shown or the extent or number of the transactions in which they would be used. In particular there was no mention of the plaintiff, a corporation doing business chiefly as a factor, which till then had never made advances to the Stern company, though it had sold merchandise in small amounts. The range of the transactions in which a certificate of audit might be expected to play a part was as indefinite and wide as the possibilities of the business that was mirrored in the summary.

By February 26, 1924, the audit was finished and the balance sheet made up. It stated assets in the sum of \$2,550,671.88 and liabilities other than capital and surplus in the sum of \$1,479,956.62, thus showing a net worth of \$1,070,715.26. Attached to the balance sheet was a certificate as follows:

'TOUCHE, NIVEN & CO.
'Public Accountants
'Eighty Maiden Lane
'New York
'February 26, 1924.
'Certificate of Auditors

'We have examined the accounts of Fred Stern & Co., Inc., for the year ending December 31, 1923, and hereby certify that the annexed balance sheet is in accordance therewith and with the information and explanations given us. We further certify that, subject to provision for federal taxes on income, the said statement, in our opinion, presents a true and correct view of the financial condition of Fred Stern & Co., Inc., as at December 31, 1923.

'TOUCHE, NIVEN & CO.
'Public Accountants.'

Capital and surplus were intact if the balance sheet was accurate. In reality both had been wiped out, and the corporation was insolvent. The books had been falsified by those in charge of the business so as to set forth accounts receivable and other assets which turned out to be fictitious. The plaintiff maintains that the certificate of audit was erroneous in both its branches. The first branch, the asserted correspondence between the accounts and the balance sheet, is one purporting to be made as of the knowledge of the auditors. The second branch, which certifies to a belief that the condition reflected in the balance sheet presents a true and correct picture of the resources of the business, is stated as a matter of opinion. In the view of the plaintiff, both branches of the certificate are either fraudulent or negligent. As to one class of assets, the item of accounts receivable, if not also as to others, there was no real correspondence, we are told, between balance sheet and books, or so the triers of the facts might find. If correspondence, however, be assumed, a closer examination of supporting invoices and records, or a fuller inquiry directed to the persons appearing on the books as creditors or debtors, would have exhibited the truth.

The plaintiff, a corporation engaged in business as a factor, was approached by Stern in March, 1924, with a request for loans of money to finance the sales of rubber. Up to that time the dealings between the two houses were on a cash basis and trifling in amount. As a condition of any loans the plaintiff insisted that it receive a balance sheet certified by public accountants, and in response to that demand it was given one of the certificates signed by the defendants and then in Stern's possession. On the faith of that certificate the plaintiff made a loan which was followed by many others. The course of business was for Stern to deliver to the plaintiff documents described as trust receipts which in effect were executory assignments of the moneys payable by purchasers for goods thereafter to be sold. When the purchase price was due, the plaintiff received the payment, reimbursing itself therefrom for its advances and commissions. Some of these transactions were effected without loss. Nearly a year later, in December, 1924, the house of cards collapsed. In that month, plaintiff made three loans to the Stern company, one of \$100,000, a second of \$25,000, and a third of \$40,000. For some of these loans no security was received. For some of the earlier loans the security was inadequate. On January 2, 1925, the Stern company was declared a bankrupt.

This action, brought against the accountants in November, 1926, to recover the loss suffered by the plaintiff in reliance upon the audit, was in its inception one for negligence. On the trial there was added a second cause of action asserting fraud also. The trial judge dismissed the second cause of action without submitting it to the jury. As to the first cause of action, he reserved his decision on the defendants' motion to dismiss, and took the jury's verdict. They were told that the defendants might be held liable if

with knowledge that the results of the audit would be communicated to creditors they did the work negligently, and that negligence was the omission to use reasonable and ordinary care. The verdict was in favor of the plaintiff for \$187,576.32. On the coming in of the verdict, the judge granted the reserved motion. The Appellate Division affirmed the dismissal of the cause of action for fraud, but reversed the dismissal of the cause of action for negligence, and reinstated the verdict. The case is here on cross-appeals.

The two causes of action will be considered in succession, first the one for negligence and second that for fraud.

We think the evidence supports a finding that the audit was negligently made, though in so saying we put aside for the moment the question whether negligence, even if it existed, was a wrong to the plaintiff. To explain fully or adequately how the defendants were at fault would carry this opinion beyond reasonable bounds. A sketch, however, there must be, at least in respect of some features of the audit, for the nature of the fault, when understood, is helpful in defining the ambit of the duty.

We begin with the item of accounts receivable. At the start of the defendant's audit, there had been no posting of the general ledger since April, 1923. Siess, a junior accountant, was assigned by the defendants to the performance of that work. On Sunday, February 3, 1924, he had finished the task of posting, and was ready the next day to begin with his associates the preparation of the balance sheet and the audit of its items. The total of the accounts receivable for December, 1923, as thus posted by Siess from the entries in the journal, was \$644,758.17. At some time on February 3, Romberg, an employee of the Stern company, who had general charge of its accounts, placed below that total another item to represent additional accounts receivable growing out of the transactions of the month. This new item, \$706,843.07, Romberg entered in his own handwriting. The sales that it represented were, each and all, fictitious. Opposite the entry were placed other figures (12-29), indicating or supposed to indicate a reference to the journal. Siess when he resumed his work saw the entries thus added, and included the new item in making up his footings, with the result of an apparent increase of over \$700,000 in the assets of the business. He says that in doing this he supposed the entries to be correct, and that his task at the moment being merely to post the books, he thought the work of audit or verification might come later, and put it off accordingly. The time sheets, which are in evidence, show very clearly that this was the order of time in which the parts of the work were done. Verification, however, there never was either by Siess or by his superiors, or so the triers of the facts might say. If any had been attempted, or any that was adequate, an examiner would have found that the entry in the ledger was not supported by any entry in the journal. If from the journal he had gone to the book from which the journal was made up, described as 'the debit memo book,' support would still have failed. Going farther, he would have found invoices, seventeen in number, which amounted in the aggregate to the interpolated item, but scrutiny of these invoices would have disclosed suspicious features in that they had no shipping number nor a customer's order number and varied in terms of credit and in other respects from those usual in the business. A mere glance reveals the difference.

The December entry of accounts receivable was not the only item that a careful and skillful auditor would have desired to investigate. There was ground for suspicion as to an item of \$113,199.60, included in the accounts payable as due from the Baltic Corporation. As to this the defendants received an explanation, not very convincing, from Stern and Romberg. A cautious auditor might have been dissatisfied and have uncovered what was wrong. There was ground for suspicion also because of the

inflation of the inventory. The inventory as it was given to the auditors, was totaled at \$347,219.08. The defendants discovered errors in the sum of \$303,863.20, and adjusted the balance sheet accordingly. Both the extent of the discrepancy and its causes might have been found to cast discredit upon the business and the books. There was ground for suspicion again in the record of assigned accounts. Inquiry of the creditors gave notice to the defendants that the same accounts had been pledged to two, three and four banks at the same time. The pledges did not diminish the value of the assets, but made in such circumstances they might well evoke a doubt as to the solvency of a business where such conduct was permitted. There was an explanation by Romberg which the defendants accepted as sufficient. Caution and diligence might have pressed investigation farther.

If the defendants owed a duty to the plaintiff to act with the same care that would have been due under a contract of employment, a jury was at liberty to find a verdict of negligence upon a showing of a scrutiny so imperfect and perfunctory. No doubt the extent to which inquiry must be pressed beyond appearances is a question of judgment, as to which opinions will often differ. No doubt the wisdom that is born after the event will engender suspicion and distrust when old acquaintance and good repute may have silenced doubt at the beginning. All this is to be weighed by a jury in applying its standard of behavior, the state of mind and conduct of the reasonable man. Even so, the adverse verdict, when rendered, imports an alignment of the weights in their proper places in the balance and a reckoning thereafter. The reckoning was not wrong upon the evidence before us, if duty be assumed.

We are brought to the question of duty, its origin and measure.

The defendants owed to their employer a duty imposed by law to make their certificate without fraud, and a duty growing out of contract to make it with the care and caution proper to their calling. Fraud includes the pretense of knowledge when knowledge there is none. To creditors and investors to whom the employer exhibited the certificate, the defendants owed a like duty to make it without fraud, since there was notice in the circumstances of its making that the employer did not intend to keep it to himself (*Eaton, Cole & Burnham Co. v. Avery*, 83 N. Y. 31; *Tindle v. Birkett*, 171 N. Y. 520). A different question develops when we ask whether they owed a duty to these to make it without negligence. 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 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. We put aside for the moment any statement in the certificate which involves the representation of a fact as true to the knowledge of the auditors. If such a statement was made, whether believed to be true or not, the defendants are liable for deceit in the event that it was false. The plaintiff does not need the invention of novel doctrine to help it out in such conditions. The case was submitted to the jury and the verdict was returned upon the theory that even in the absence of a misstatement of a fact there is a liability also for erroneous opinion. The expression of an opinion is to be subject to a warranty implied by law. What, then, is the warranty, as yet unformulated, to be? Is it merely that the opinion is honestly conceived and that the preliminary inquiry has been honestly pursued, that a halt has not been made without a genuine belief that the search has been reasonably adequate to bring disclosure of the truth? Or does it go farther and involve the assumption of a liability for any blunder or

inattention that could fairly be spoken of as negligence if the controversy were one between accountant and employer for breach of a contract to render services for pay?

The assault upon the citadel of privity is proceeding in these days apace. How far the inroads shall extend is now a favorite subject of juridical discussion (Williston, *Liability for Honest Misrepresentation*, 24 Harv. L. Rev. 415, 433; Bohlen, *Studies in the Law of Torts*, pp. 150, 151; Bohlen, *Misrepresentation as Deceit, Negligence or Warranty*, 42 Harv. L. Rev. 733; Smith, *Liability for Negligent Language*, 14 Harv. L. Rev. 184; Green, *Judge and Jury*, chapter Deceit, p. 280; 16 Va. Law Rev. 749). In the field of the law of contract there has been a gradual widening of the doctrine of *Lawrence v. Fox* (20 N. Y. 268), until today the beneficiary of a promise, clearly designated as such, is seldom left without a remedy (*Seaver v. Ransom*, 224 N. Y. 233, 238). Even in that field, however, the remedy is narrower where the beneficiaries of the promise are indeterminate or general. Something more must then appear than an intention that the promise shall redound to the benefit of the public or to that of a class of indefinite extension. The promise must be such as to 'bespeak the assumption of a duty to make reparation directly to the individual members of the public if the benefit is lost' (*Moch Co. v. Rensselaer Water Co.*, 247 N. Y. 160, 164; American Law Institute, *Restatement of the Law of Contracts*, § 145). In the field of the law of torts a manufacturer who is negligent in the manufacture of a chattel in circumstances pointing to an unreasonable risk of serious bodily harm to those using it thereafter may be liable for negligence though privity is lacking between manufacturer and user (*MacPherson v. Buick Motor Co.*, 217 N. Y. 382; American Law Institute. *Restatement of the Law of Torts*, § 262). A force or instrument of harm having been launched with potentialities of danger manifest to the eye of prudence, the one who launches it is under a duty to keep it within bounds (*Moch Co. v. Rensselaer Water Co.*, supra, at p. 168). Even so, the question is still open whether the potentialities of danger that will charge with liability are confined to harm to the person, or include injury to property (*Pine Grove Poultry Farm v. Newton B.-P. Mfg. Co.*, 248 N. Y. 293, 296; *Robins Dry Dock & Repair Co. v. Flint*, 275 U. S. 303; American Law Institute, *Restatement of the Law of Torts*, supra). In either view, however, what is released or set in motion is a physical force. We are now asked to say that a like liability attaches to the circulation of a thought or a release of the explosive power resident in words.

Three cases in this court are said by the plaintiff to have committed us to the doctrine that words, written or oral, if negligently published with the expectation that the reader or listener will transmit them to another, will lay a basis for liability though privity be lacking. These are *Glanzer v. Shepard* (233 N. Y. 236); *International Products Co. v. Erie R. R. Co.* (244 N. Y. 331), and *Doyle v. Chatham & Phenix Nat. Bank* (253 N. Y. 369).

In *Glanzer v. Shepard* the seller of beans requested the defendants, public weighers, to make return of the weight and furnish the buyer with a copy. This the defendants did. Their return, which was made out in duplicate, one copy to the seller and the other to the buyer, recites that it was made by order of the former for the use of the latter. The buyer paid the seller on the faith of the certificate which turned out to be erroneous. We held that the weighers were liable at the suit of the buyer for the moneys overpaid. Here was something more than the rendition of a service in the expectation that the one who ordered the certificate would use it thereafter in the operations of his business as occasion might require. Here was a case where the transmission of the certificate to another was not merely one possibility among many, but the 'end and aim

endeavor to emphasize the character of the certificate as a business transaction, an act in the law, and not a mere casual response to a request for information. The ruling in the case of the Erie Railroad shows that the rendition of a service is at most a mere circumstance and not an indispensable condition. The Erie was not held for negligence in the rendition of a service. It was held for words and nothing more. So in the case at hand. If liability for the consequences of a negligent certificate may be enforced by any member of an indeterminate class of creditors, present and prospective, known and unknown, the existence or non-existence of a preliminary act of service will not affect the cause of action. The service may have been rendered as carefully as you please, and its quality will count for nothing if there was negligence thereafter in distributing the summary.

Doyle v. Chatham & Phenix Nat. Bank (supra), the third of the cases cited, is even more plainly indecisive. A trust company was a trustee under a deed of trust to secure an issue of bonds. It was held liable to a subscriber for the bonds when it certified them falsely. A representation by a trustee intended to sway action had been addressed to a person who by the act of subscription was to become a party to the deed and a cestui que trust.

The antidote to these decisions and to the over-use of the doctrine of liability for negligent misstatement may be found in *Jaillet v. Cashman* (235 N. Y. 511) and *Courteen Seed Co. v. Hong Kong & Shanghai Banking P. Corp.* (245 N. Y. 377). In the first of these cases the defendant supplying ticker service to brokers was held not liable in damages to one of the broker's customers for the consequences of reliance upon a report negligently published on the ticker. If liability had been upheld, the step would have been a short one to the declaration of a like liability on the part of proprietors of newspapers. In the second the principle was clearly stated by POUND, J., that 'negligent words are not actionable unless they are uttered directly, with knowledge or notice that they will be acted on, to one to whom the speaker is bound by some relation of duty, arising out of public calling, contract or otherwise, to act with care if he acts at all.'

From the foregoing analysis the conclusion is, we think, inevitable that nothing in our previous decisions commits us to a holding of liability for negligence in the circumstances of the case at hand, and that such liability, if recognized, will be an extension of the principle of those decisions to different conditions, even if more or less analogous. The question then is whether such an extension shall be made.

The extension, if made, will so expand the field of liability for negligent speech as to make it nearly, if not quite, coterminous with that of liability for fraud. Again and again, in decisions of this court, the bounds of this latter liability have been set up, with futility the fate of every endeavor to dislodge them. *Scienter* has been declared to be an indispensable element except where the representation has been put forward as true of one's own knowledge (*Hadcock v. Osmer*, 153 N. Y. 604), or in circumstances where the expression of opinion was a dishonorable pretense (3 *Williston, Contracts*, § 1494; *Smith v. Land & House Prop. Corp.*, [L. R.] 28 Ch. Div. 7, 15; *Sleeper v. Smith*, 77 N. H. 337; *Andrews v. Jackson*, 168 Mass. 266; *People ex rel. Gellis v. Sheriff*, 251 N. Y. 33, 37; *Hickey v. Morrell*, 102 N. Y. 454, 463; *Merry Realty Co. v. Martin*, 103 Misc. Rep. 9, 14; 186 App. Div. 538). Even an opinion, especially an opinion by an expert, may be found to be fraudulent if the grounds supporting it are so flimsy as to lead to the conclusion that there was no genuine belief back of it. Further than that this court has never gone. Directors of corporations have been acquitted of liability for deceit though they have been lax in investigation and negligent in speech (*Reno v. Bull*, 226 N. Y. 546, and cases

there cited; *Kountze v. Kennedy*, 147 N. Y. 124). This has not meant, to be sure, that negligence may not be evidence from which a trier of the facts may draw an inference of fraud (*Derry v. Peek*, [L. R.] 14 A. C. 337, 369, 375, 376), but merely that if that inference is rejected, or, in the light of all the circumstances, is found to be unreasonable, negligence alone is not a substitute for fraud. Many also are the cases that have distinguished between the willful or reckless representation essential to the maintenance at law of an action for deceit, and the misrepresentation, negligent or innocent, that will lay a sufficient basis for rescission in equity (*Bloomquist v. Farson*, 222 N. Y. 375; *Seneca Wire & Mfg. Co. v. Leach & Co.*, 247 N. Y. 1). If this action is well conceived, all these principles and distinctions, so nicely wrought and formulated, have been a waste of time and effort. They have even been a snare, entrapping litigants and lawyers into an abandonment of the true remedy lying ready to the call. The suitors thrown out of court because they proved negligence, and nothing else, in an action for deceit, might have ridden to triumphant victory if they had proved the self-same facts, but had given the wrong another label, and all this in a State where forms of action have been abolished. So to hold is near to saying that we have been paltering with justice. A word of caution or suggestion would have set the erring suitor right. Many pages of opinion were written by judges the most eminent, yet the word was never spoken. We may not speak it now. A change so revolutionary, if expedient, must be wrought by legislation (*Landell v. Lybrand*, 264 Penn. St. 406).

We have said that the duty to refrain from negligent representation would become coincident or nearly so with the duty to refrain from fraud if this action could be maintained. A representation even though knowingly false does not constitute ground for an action of deceit unless made with the intent to be communicated to the persons or class of persons who act upon it to their prejudice (*Eaton, Cole & Burnham Co. v. Avery*, *supra*). Affirmance of this judgment would require us to hold that all or nearly all the persons so situated would suffer an impairment of an interest legally protected if the representation had been negligent. We speak of all 'or nearly all,' for cases can be imagined where a casual response, made in circumstances insufficient to indicate that care should be expected, would permit recovery for fraud if willfully deceitful. Cases of fraud between persons so circumstanced are, however, too infrequent and exceptional to make the radii greatly different if the fields of liability for negligence and deceit be figured as concentric circles. The like may be said of the possibility that the negligence of the injured party, contributing to the result, may avail to overcome the one remedy, though unavailing to defeat the other.

Neither of these possibilities is noted by the plaintiff in its answer to the suggestion that the two fields would be coincident. Its answer has been merely this, first, that the duty to speak with care does not arise unless the words are the culmination of a service, and second, that it does not arise unless the service is rendered in the pursuit of an independent calling, characterized as public. As to the first of these suggestions, we have already had occasion to observe that given a relation making diligence a duty, speech as well as conduct must conform to that exacting standard (*International Products Co. v. Erie R. R. Co.*, *supra*). As to the second of the two suggestions, public accountants are public only in the sense that their services are offered to any one who chooses to employ them. This is far from saying that those who do not employ them are in the same position as those who do.

Liability for negligence if adjudged in this case will extend to many callings other than an auditor's. Lawyers who certify their opinion as to the validity of municipal or