THE PASCHOS LAW UPDATE NEWSLETTER
THOMAS PASCHOS & ASSOCIATES P.C.
ATTORNEYS AT LAW

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I. PROFESSIONAL LIABILITY

Accountant Cannot be Held Liable to Third Parties Without Specific Knowledge That Third Parties Will Rely On Its Reports

In *Cast Art Industries, LLC v. KPMG LLP*, --- A.3d ----, 2012 WL 489229 (N.J. February 16, 2012), plaintiff, Cast Art Industries (Cast Art), was a producer and seller of collectible figurines and giftware. Papel Giftware (Papel) was in the same line of business as Cast Art, and in the spring of 2000 Cast Art became interested in acquiring Papel. Eventually, Cast Art decided that a merger, rather than an acquisition, would be the preferable format for such a transaction. Cast Art lacked the financial ability to complete such a transaction on its own. As a result, it negotiated a loan agreement with PNC Bank (PNC) for $22 million to fund the venture. One of PNC's conditions to advancing the $22 million loan, however, was that it receive audited financial statements of Papel.

Defendant KPMG had audited Papel's financial statements since 1997, when Papel's principal had acquired it from a prior owner. KPMG was already in the process of auditing Papel's 1998 and 1999 financial statements when Cast Art and Papel began their merger discussions. Cast Art obtained copies of the completed 1998 and 1999 audits and provided copies to PNC in satisfaction of its obligation under the loan agreement. Three months later, in December 2000, Cast Art and Papel consummated the merger. Shortly after the merger was finalized, Cast Art began to experience difficulty in collecting some of the accounts receivable that it had believed Papel had had outstanding prior to the merger. Cast Art began its own investigation and learned that the 1998 and 1999 financial statements prepared by Papel were inaccurate and that Papel evidently had engaged regularly in the practice of accelerating revenue.

Plaintiffs commenced this litigation seeking damages for the losses they said they incurred following its bankruptcy and subsequent liquidation. Cast Art alleged that KPMG negligently audited Papel because its audit had not revealed Papel's accounting irregularities and sought to recover for the loss of its business. It contended that if KPMG had performed a proper audit, it would have uncovered the fraudulent accounting activity that was taking place at Papel. Cast Art further maintained that it never would have proceeded with the merger if it had been alerted to this fraud. Thus, Cast Art asserted that its losses were caused by KPMG's negligence, and it argued that KPMG should be responsible to make it whole.

KPMG defended this litigation arguing that because Cast Art had not retained it to audit Papel, Cast Art was not its client, and Cast Art's claim was consequently barred by the Accountant Liability Act, N.J.S.A. 2A:53A–25. Prior to trial, KPMG unsuccessfully sought summary judgment

on that basis. Cast Art prevailed in the trial court. On appeal, KPMG argued that, among other things, Cast Art's action was precluded by N.J.S.A. 2A:53A–25. The Appellate Division rejected KPMG's statutory argument, as well as the bulk of KPMG's other arguments. It did concur, however, that Cast Art's proofs with respect to its damages were insufficient, and it thus set aside the judgment entered by the trial court and remanded the matter for a new trial on damages only. Defendant petitioned for certification, and plaintiffs submitted a cross-petition, both of which were granted.

KPMG presented a number of arguments in support of its position. It contended that the construction placed on N.J.S.A. 2A:53A–25 by the trial court and the Appellate Division was incorrect and had the effect of reinstating foreseeability as the test to determine the scope of accountant liability to third parties. KPMG asserted that under the proper construction of the Accountant Liability Act, it could not be held liable to Cast Art because KPMG did not know at the time it agreed to perform these audits that Papel and Cast Art were contemplating a merger and that Cast Art would be relying on its auditing work. Cast Art, on the other hand, rejected KPMG's construction of N.J .S.A. 2A:53A–25. It contended that an accountant may be held liable to a third party if the accountant, at any time prior to the completion of its work, knows that its work will be made available to, and will be relied on by, that nonclient third party.

The New Jersey Supreme Court analyzed the statute and the historical development of the manner in which courts have addressed the issue of an auditor's potential liability to nonclient third parties. The court’s conclusion with respect to the proper construction of the Accountant Liability Act was that an auditor's “liability must be defined by the scope of the engagement it entered.” The court provided that an auditor is entitled to know at the outset the scope of the work it is being requested to perform and the concomitant risk it is being asked to assume. The court noted that the pertinent language of KPMG's engagement letter with Papel with respect to the audits was silent as to Cast Art. Thus, at the outset of its engagement with Papel, KPMG was not told that a nonclient would be relying on its work.

Cast Art contended that its cause of action nonetheless fits within that portion of the statute permitting a third party to seek recovery from an accountant if the accountant “agreed with the client after the time of the engagement, that the professional accounting service rendered to the client would be made available to the claimant, who was specifically identified to the accountant in connection with a specified transaction made by the claimant.” N .J.S.A. 2A:53A–25(b)(2)(a). The court did not agree and held that because Cast Art failed to establish that KPMG “knew at the time of the engagement by the client” or thereafter agreed that Cast Art could rely on its work in proceeding with this merger, Cast Art failed to satisfy the requisite elements of N.J.S.A. 2A:53A–25(b)(2), and KPMG was entitled to judgment.

II. <u>EMPLOYMENT LITIGATION</u>

<u>FMLA Permits Individual Liability Against Supervisors at Public Agencies</u>

In *Haybarger v. Lawrence County Adult Probation and Parole* , __ F.3d __, 2012 WL 265996 (3d Cir. (Pa.) January 31, 2012), Plaintiff Debra Haybarger, who worked as an office manager for Lawrence County Adult Probation and Parole (“Lawrence County Probation”), an agency of the Lawrence County Court of Common Pleas, missed work frequently to seek medical attention for

Type II diabetes, heart disease and kidney problems. Her supervisor, William Mancino, was critical of Haybarger's need to take health-related absences and eventually advised the agency to terminate her employment. Haybarger filed suit against Lawrence County Probation, the County of Lawrence, and Mancino under the Americans with Disabilities Act (“ADA”), the Pennsylvania Human Relations Act (“PHRA”), the Rehabilitation Act, alleging that Mancino and the agency terminated her because of her medical conditions. The district court granted summary judgment in favor of Mancino, finding that he could not be found liable under the FMLA because he did not have sufficient control over Haybarger's employment since he did not have the final authority to fire her. Haybarger appealed.

On appeal, Haybarger argued that the District Court erred in holding that, as a matter of law, Mancino was not her “employer” under the FMLA. The Third Circuit held the issue of whether a supervisor in a public agency may be subject to individual liability under the FMLA to be one of first impression. The court analyzed the statute and the holdings of courts in other jurisdictions and concluded that an individual supervisor at a public agency may be held liable under the FMLA.

The court then turned to whether Mancino was Haybarger's employer under the FMLA. The court examined the extent of Mancino's control over Haybarger's work situation. The court noted that Mancino exercised substantial authority over Haybarger's termination decision, even if he lacked final authority to dismiss her. Most importantly, Mancino admitted that he advised the President Judge to terminate her. Additionally, Mancino was present at the meeting when Haybarger was informed of her termination, and he wrote her termination letter, in which he stated, “I feel that no progress or [sic] has been made by you ... [so][a]fter conferring with the District Court Administrator, Michael Occhibone, and the President Judge, Dominick Motto, we are in agreement that your termination ... is necessary.” As such, the court determined that Mancino had sufficient control over Haybarger's employment so as to be subject to liability for a violation of the FMLA. The court vacated the District Court's grant of summary judgment on Haybarger's FMLA claim against William Mancino and remand for further proceedings.

III. GENERAL LITIGATION

Emails Exchanged Between Counsel Construed As Written Modifications of Arbitration Agreement

In *T & Beer, Inc. v. Wine Source Selections, LLC* , 2012 WL 360286 (N.J. Super. February 6, 2012), unpublished, Plaintiff was engaged in the wholesale distribution of beer and wine, primarily in New York and New Jersey. Defendant was a supplier and importer of wine and other alcoholic beverages. Under the Agreement, defendant agreed to sell to plaintiff, as a distributor, the products listed in the Agreement's appendix in New York and New Jersey “on an exclusive basis.” The Agreement provided for arbitration of all disputes between the parties and written modification of any terms of the agreement.

Plaintiff claimed that contrary to the terms of the Agreement, other retailers and wholesale distributors were distributing products in New York and New Jersey that were subject to its exclusive distributorship with defendant. Plaintiff, in accordance with the Agreement, demanded arbitration. Arbitration did not immediately occur. Instead, through their respective attorneys, the

parties engaged in negotiations, which were memorialized in a series of emails exchanged between counsel. In one such email from defense counsel dated September 24, 2010, defense counsel consented to having the claims asserted by T & Beer removed from arbitration and heard in the Superior Court. Defense counsel also consented to personal jurisdiction. In addition, defense counsel agreed to accept service of the “Summons and Complaint via regular mail and/or email.”

On October 11, 2010, plaintiff filed a verified complaint for injunctive relief to enforce the restrictive covenant contained in the Agreement and for reformation of the Agreement. Four days later, the court issued an order to show cause with temporary restraints temporarily restraining defendants from acting in “concert with any person or entity to distribute or sell any of the products” subject to the Agreement. On February 10, 2011, the court issued a preliminary injunction in favor of plaintiff.

On March 2, 2011, defendant filed a motion to dismiss plaintiff's complaint. In support of the motion, defendant’s CEO submitted a certification stating that any disputes involving the Agreement were subject to arbitration and that Wine Source “never agreed to have any disputes arising out of the Distribution Agreement to be decided by this [c]ourt.” Plaintiff opposed the motion, arguing that defendant, through its attorney, “consistently represented to this [c]ourt ... that this matter is properly before the [c]ourt and that they submit to the jurisdiction of this [c]ourt” and “have waived submitting this matter to arbitration.”

The trial court found no such waiver. The court acknowledged that stipulations by attorneys and their clients before the court are enforceable. Nonetheless, the court reasoned that given the explicit language of the Agreement that “[n]o modification or waiver of any provision of this Agreement shall be effective unless in writing and signed by the parties,” the absence of a document executed between the parties explicitly waiving arbitration did not preclude defendant from “now seeking enforcement of the arbitration provision.” The present appeal followed.

The appeals court concluded, as did the trial court, that the Agreement expressly and unequivocally calls for arbitration of disputes between the parties and written modification of any of the terms of the Agreement. The court disagreed, however, with the trial court's conclusion that there was no written modification of the arbitration provisions. The court was persuaded that the emails sent in September of 2010 satisfied the requirement that any modification of the terms of the agreement must be in writing and signed by the parties. Moreover, the court found that the parties' actions thereafter clearly and convincingly represented additional evidence demonstrating defendant's knowing and voluntary waiver of the arbitration provisions contained in the Agreement.

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