

Client Alert

New York Court of Appeals Makes It More Difficult for Accounting Malpractice Plaintiffs to Avoid Statute of Limitations Problems Under “Continuous Representation” Doctrine

In a case of significance to the accounting profession, New York’s top court, the Court of Appeals, held on June 7, 2007, that the “continuous representation” doctrine did not toll the running of the statute of limitations for accounting malpractice claims when an audit client merely entered into annual engagements with the accounting firm for the provision of “separate and discrete audit services” for each audit year. A mere general “continuing professional relationship” between the plaintiff and its auditor, held the Court, was not the same as “a course of representation as to the particular problems (conditions) that gave rise to the plaintiff’s malpractice claim.” The Court held that only the latter would warrant applying the “continuous representation” doctrine to toll the statute of limitations. The decision, in *Williamson v. PricewaterhouseCoopers LLP*, 2007 N.Y. slip op. 4719, 2007 N.Y. LEXIS 1455 (June 7, 2007), marked the first time that the New York Court of Appeals had addressed the applicability of the “continuous representation” doctrine in the accounting malpractice context.

Claims Arising from Successive Annual Audits

In *Williamson*, the defendant auditor had been engaged since 1990 to perform annual audits of the year-end financial statements of certain investment funds. According to the complaint, after the auditor completed the fiscal year 2000 audit, it was discovered in or about February 2002 that the funds’ former portfolio manager had used an improper valuation method, which had materially overstated the value of the funds’ securities holdings. Many of the funds’ limited partners then withdrew their investments from the funds, leading the funds to be dissolved and a liquidating trustee appointed. The liquidating trustee then commenced an accounting malpractice action against the auditor, claiming that there had been improper audits of the funds’ financial statements for fiscal years 1995 through 2000 (the last year audited prior to the accounting firm’s termination as auditor).

The accounting firm moved to dismiss, arguing that the malpractice claims as to all but the last of the audit years were time-barred under New York’s three-year statute of limitations for professional malpractice claims (CPLR 214(6)). The liquidating trustee countered that the statute of limitations should be tolled by the continuous representation doctrine, which had been applied in accounting malpractice actions by a number of lower courts to toll the statute of limitations until the overall accountant-client relationship had terminated.

The trial court granted the motion to dismiss as to the 1995-1999 audits, holding that the performance of audits in succeeding years merely “constituted the continuation of a general professional relationship,” and as such was insufficient to toll the statute of limitations under the continuous representation doctrine. However, a sharply divided panel of the Appellate Division, First Department, reversed and reinstated the claims in a 3-2 decision. Noting that the complaint alleged that each year’s audit “incorporated and built upon the services rendered in the prior years”

by taking “as its starting point the improper valuations and inflated asset figures the firm had certified in the previous year, rather than reviewing those statements for accuracy as a new auditor could be expected to do,” the Appellate Division concluded that an issue of fact had been raised as to whether each audit was merely a step in a continuous and interrelated service, and that the liquidating trustee should therefore be afforded the opportunity to develop this point further through discovery.

“Continuous Representation” Clarified

The Court of Appeals disagreed with the Appellate Division and reversed in a unanimous opinion. The Court explained that the use of the continuous representation doctrine in the context of accountants’ liability actions arose from the “continuous treatment” doctrine originally recognized in medical malpractice cases. Under that doctrine, “‘when the course of treatment which includes the wrongful acts or omissions has run continuously and is related to the same original condition or complaint,’ the limitations period does not begin to run until the end of the treatment.” The reason for the doctrine is that a patient who is continuing to receive corrective treatment “related to the conditions produced by the earlier wrongful acts and omissions” should not be required to interrupt the course of that treatment just to assert a malpractice claim that would otherwise expire.

Applying those basic principles to the accountants’ context in *Williamson*, the Court of Appeals observed that there was no allegation that the auditor and the funds “explicitly contemplated” further representation by the auditor regarding the prior audits after they had been completed. The Funds never engaged the auditor to “provide corrective or remedial services,” such as “to reexamine a prior year’s financial statements or redo a prior year’s audit.” Accordingly, applying the medical malpractice analogy, there was no continuing course of treatment, or any awareness by the funds of a need for further representation as to the audits.

Given the absence of any engagement to provide corrective or remedial services with respect to the earlier years’ audits, or any “mutual understanding” by the parties which contemplated further representation regarding those audits, the Court held that the liquidating trustee had alleged merely a continuing professional relationship with the auditor, but “not a course of representation as to the particular problems (conditions) that gave rise to plaintiff’s malpractice claims.” Accordingly, it held, the continuous representation doctrine did not apply to toll the statute of limitations in these circumstances.

Future Implications of *Williamson*

Williamson adopted a narrow view of the factual circumstances under which the continuous representation doctrine will be available to toll the statute of limitations for accounting malpractice claims. The decision makes clear that under New York law, when an auditor performs separate and discrete yearly audits, even year after year, but no further work as to each year’s audit is undertaken or contemplated thereafter, the continuous representation doctrine will not apply.

The practical consequences of this ruling are significant. The ability to exclude accounting malpractice claims based on audits going back beyond three years will eliminate certain claims that might otherwise have been brought or result in reducing the potential damages that can be claimed in actions that are nevertheless timely brought. Further, the ability to get such claims dismissed at the pleadings stage, before discovery, greatly reduces the *in terrorem* settlement value that such claims might otherwise have possessed. Moreover, because a number of states outside New York also recognize a continuous representation or relationship rule in accounting malpractice actions, *Williamson* may influence how such doctrines are interpreted in those other jurisdictions.

However, while the Court interpreted narrowly the factual circumstances where the continuous representation doctrine might apply, it did not reject the doctrine entirely in the accounting malpractice context. Further litigation can no doubt be expected with respect to the scope of the doctrine in various circumstances, including where a company's regular auditors may have been engaged to reexamine or redo their prior year's audit, such as in connection with a restatement or reissuance of previously audited financial statements. Moreover, even in the successive-annual-audits context like that in *Williamson*, aggressive plaintiffs will likely continue to explore whether there are any kinds of supplemental allegations that could be added to a complaint which might suffice to bring the doctrine into play, so as to avoid dismissals of malpractice claims at the pleadings stage.

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