IS PRIVITY DEAD? SHOULD IT BE?

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I.
INTRODUCTION

Privity. A concept that is over 150 years old and firmly rooted in American Jurisprudence. The outline of the concept is simple: a contracting party's duties and obligations only extend to other contracting parties. The theory behind the concept is also simple: a contracting party's obligation is so limited because of the concern that recognition of a duty owed to a third party could potentially impact the obligations of the contracting party, thus creating a conflict of interest.

That concept may have served its purpose in the nineteenth century, when business was conducted face-to-face and when multi-national corporations, national accounting firms, law firms, supermarkets, and super-sized "big box" stores did not exist. Today, however, the concept seems outdated. While in the nineteenth century a person obtained goods and

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services directly from the source – e.g. a local blacksmith, merchant, or farmer – today, the manufacturer of the product is typically far removed from the ultimate purchaser or user. In addition, while 100 years ago a person may have sought the advice of an agent, accountant, or other service provider, it would have been difficult to imagine that such advice could be distributed to millions of people with the possibility of hundreds of millions of dollars in losses for negligent performance.[1] Today, this is not just possible but commonplace in the accounting and insurance industries.

The question then becomes whether a concept designed for nineteenth-century business – even one as firmly rooted in American jurisprudence as privity – is still effective for twenty-first-century business. An examination of current conditions reveals that the historical concept of privity is no longer viable in today's legal climate.

There are two distinct kinds of claim to which the doctrine of privity applies in American law: i) claims brought solely to recover economic damages and ii) claims for bodily injury. When the damages sought are purely economic, many courts closely adhere to the privity requirement. In the case of bodily injuries, courts are much more likely to, but do not always, abandon the concept of privity to permit an injured third party to recover against a negligent non-contracting party.

The legal theory that requires privity of contract for recovery in a negligence action derives from an English case decided over 150 years ago: the seminal case of *Winterbottom v. Wright*,[2] which involved a breach of contract claim rather than negligence. The question today is whether the perceived holding of *Winterbottom* (one that is arguably dictum) should still be the law today.

The current economic climate and recent investor scandals demonstrate why this issue is particularly important today. As the law currently stands, accountants, finance professionals, stock brokers and advisers, lawyers, and consultants may be insulated from liability arising from their negligent conduct with

1. *See, e.g.*, BDO Seidman, LLP v. Banco Espirito Santo Int'l., 38 So. 3d 874 (Fla. Dist. Ct. App 2010) (reversing on procedural grounds a jury award of over $521 million to noteholders who relied on BDO's audit).

2. Winterbottom v. Wright, 10 M. & W. 109 (Exch. 1842).

respect to third parties so long as there is no contractual privity between them, even if the third parties are easily identifiable and their injuries reasonably foreseeable. This article will argue that the privity requirement should be abandoned because it is outdated and is based upon a misinterpretation of *Ultramares Corp. v. Touche*, the leading American case regarding the application of privity to cases involving purely economic damages.[3]

II.
DUTY

The concept of duty is fundamental to negligence law. Simply put, "there is no negligence unless there is in a particular case a legal duty of care, and this duty must be one which is owed to the plaintiff himself and not merely to others."[4] The number of cases analyzing when a defendant owes a duty to a particular plaintiff, as opposed to the world at large, is almost too large to count. There are only slightly fewer cases addressing whether a contracting party owes a duty to a third party.

At common law, privity was required for one to owe a duty to another.[5] *Winterbottom* and its progeny instituted this privity requirement, but the courts almost immediately began to carve out exceptions to it. The requirement has essentially been eliminated in negligence cases resulting in bodily injury or death.[6] In contrast, many courts retain the privity requirement for claims of purely economic damage. The reasoning behind this continued adherence to privity, however, is entirely lacking.

3. 174 N.E. 441 (N.Y. 1931).

4. Palsgraf v. Long Island R.R. Co., 162 N.E. 99, 102 (N.Y. 1928) (quoting SIR JOHN WILLIAM SALMOND, THE LAW OF TORTS: A TREATISE ON THE ENGLISH LAW OF LIABILITY FOR CIVIL INJURIES 24 (6th ed. 1924)).

5. *See Ultramares*, 174 N.E. at 445.

6. *See, e.g.*, MacPherson v. Buick Motor Co., 111 N.E. 1150 (N.Y. 1916). However, privity is still required in some instances. *See, e.g.*, Espinal v. Melville Snow Contractors, Inc., 773 N.E.2d 485 (N.Y. 2002) (contractor hired by employer to perform snow removal services in employer's parking lot held not liable to employee who fell because contractor had no duty to monitor weather to see if melting and refreezing would create icy conditions).

The concept of "duty" is constantly changing.[7] The concept of foreseeability has been universally adopted in determining whether, and to what extent, a duty exists in negligence cases involving bodily injury or death. Adapting a form of the foreseeable party standard to the economic injuries of third parties makes sense in creating a more fair and just negligence standard.

At common law, no general duty was owed by one to another. The duty could only arise from an independent source such as contract or statute. Accordingly, when the law of torts and negligence was being developed in the late eighteenth and early nineteenth centuries,[8] the requirement of an external source of duty was incorporated into the law. This began to change in the early twentieth century, with the New York Court of Appeals and one of its members in particular, Benjamin Cardozo, leading the way.

In the first half of the twentieth century, five significant cases dealing with a party's duty, or lack thereof, were considered by the New York Court of Appeals, all of which were written by then Judge Cardozo: *MacPherson v. Buick Motor Co.*,[9] *Glanzer v. Shepard*,[10] *Moch v. Rensselaer*,[11] *Palsgraf v. Long Island R.R.*,[12] and *Ultramares Corp. v. Touche*.[13] Together, these cases compose the foundation for U.S. negligence doctrine and are still followed to varying degrees today. Indeed, the principles expounded by these cases – duty, proximate cause, and the reasonableness standard – all remain good law today. The only distinction that has emerged over the years is in the application of those principles.

The main thrust of the foundational negligence cases is that, without a duty owed to the injured party, there is no cause of action for negligence.[14] The determination of whether a defendant owes a duty to a plaintiff is a question of

7. Glanzer v. Shepard, 135 N.E. 275, 276 (N.Y. 1922) ("Constantly the bounds of duty are enlarged by knowledge of a prospective use.").

8. Warren A. Seavey, *Reliance Upon Gratuitous Promises*, 64 HARV. L. REV. 913, 914 (1951).

9. 111 N.E. 1050 (N.Y. 1916).

10. 135 N.E. 275 (N.Y. 1922).

11. 159 N.E. 896 (N.Y. 1928).

12. 162 N.E. 99 (N.Y. 1928).

13. 174 N.E. 441 (N.Y. 1931).

14. *E.g.*, *Palsgraf*, 162 N.E. at 99.

law to be decided by the court.[15] Thus, in assessing whether a defendant is liable for particular injuries, the court holds great power in determining what actions of a defendant are, or could be, negligent. Although other issues involved in negligence actions are generally questions of fact to be decided by a jury, the judge's power to decide the scope of duty allows the judiciary to control the scope of liability.

A. *Duty in General*

The key issue in determining whether a duty exists is foreseeability. Chief Judge Benjamin Cardozo, in an opinion from the New York Court of Appeals, provided perhaps the most famous expression of the scope of duty: "The risk reasonably to be perceived defines the duty to obey, and risk imports relations; it is risk to another or to others within the range of apprehension."[16] In order for a defendant to owe a duty to a plaintiff, the plaintiff must show that "the act as to him had possibilities of danger so many and apparent as to entitle him to be protected against the doing of it though the harm was unintended."[17]

Judge Cardozo articulated a fundamental principle of negligence law: without a duty, there is no wrong. It follows from this principle that without a wrong, there is no necessity to determine whether the conduct proximately caused injury. In the *Palsgraf* opinion, Cardozo firmly embedded the concept of foreseeability into the scope of duty.[18] A defendant owes a duty to the foreseeable plaintiff, not the unforeseeable plaintiff.[19] This has been the foundation of American negligence law for nearly 100 years.

A clearly defined principle of duty is necessary in order for actors to know what conduct is expected of them. This is particularly true of contracting parties. Contractually bound parties must be able to take into account potential liability exposure when setting a price for the services they provide, obtaining insurance to cover potential liability, and making the ultimate decision of whether to take on a job or client. The

15. Eiseman v. State, 511 N.E.2d 1128, 1136 (N.Y. 1987).
16. *Palsgraf*, 162 N.E. at 100.
17. *Id.* at 101.
18. *Id.* at 100.
19. *Id.*

duties imposed on the contracting party, and thus the party's potential exposure, must be known *before* the contracting party accepts the job and begins work.

B. *Duty in Bodily Injury Cases*

1. *MacPherson*

Cardozo began his reinterpretation of negligence principles in *MacPherson v. Buick Motor Company.*[20] *MacPherson* analyzed whether contractual privity was necessary in order to hold a manufacturer of a defective product liable to a person that, while not the purchaser, was a reasonably foreseeable user of the product.[21] *MacPherson* involved a Buick automobile with a defective wheel that was sold to a dealer and subsequently purchased by a consumer.[22] The plaintiff was a passenger in the vehicle when the wheel broke; the vehicle was involved in a collision which caused the injuries complained of in the suit.[23] Thus, the plaintiff had no direct relationship to Buick. Even absent satisfaction of the contractual privity requirement, the court, led by Judge Cardozo, nonetheless found that the plaintiff could maintain an action against Buick.[24]

In *MacPherson,* Cardozo began developing the groundwork for the foreseeability principle that would be more fully articulated in *Palsgraf.* In *MacPherson,* Cardozo stated, "Because the danger is to be foreseen, there is a duty to avoid the injury."[25] Cardozo noted that earlier decisions holding in favor of the manufacturer – that is, holding that there is no liability in the absence of privity – relied upon the distinction that the conduct, though negligent, was not likely to result in injury to anyone except the purchaser.[26] There was no liability to third parties in such cases because injury to them was not foreseeable.

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20. 111 N.E. 1050 (N.Y. 1916).
21. *Id.*
22. *Id.* at 1051.
23. *Id.*
24. *Id.* at 1054-55.
25. *Id.* at 1051.
26. *Id.* ("The principle of the distinction is for the present purposes the important thing.").

In *MacPherson,* Cardozo emphasized that he was not changing established principles, that he was only changing their application.[27] The court analyzed decisions of earlier cases, including *Thomas v. Winchester,*[28] which permitted a claim by an end user against the manufacturer of a poison that was falsely labeled. *Thomas* abandoned the privity requirement but limited this departure to cases of inherently dangerous situations.[29] In light of *Thomas, MacPherson* thus recognized that the creator of an item might be liable to a foreseeable end user.

> Whenever one person supplies goods, or machinery, or the like, the purpose of their being used by another person under such circumstances that every one of ordinary sense would, if he thought, recognized at once that unless he used ordinary care and skill with regard to the condition of the thing supplied or the mode of supplying it, there will be danger of injury to the person or property of him for whose use the thing is supplied, and who is to use it, a duty arises to use ordinary care and skill as to the condition or manner of supplying such thing.[30]

Cardozo recognized that a supplier of an instrumentality must use ordinary care and skill as to the condition or manner of supplying the instrumentality when it is foreseeable that the instrumentality may cause injury. This is the basis of modern product liability law. If, in addition to the element of danger, there is the added knowledge that the product will be used by persons other than the purchaser without inspection or new tests, then, irrespective of conduct, the manufacturer of the item is under a duty to produce it carefully.[31] There is no reason why, in the twenty-first century, these principles cannot be applied to the negligent creation of items that cause purely economic damage.

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27. *Id.* ("In the application of its principle, there may at times have been uncertainty or even error. There has never in this State been doubt or disavowal of the principle itself.").

28. 6 N.Y. 397 (1852).

29. *Id.* at 410-11.

30. *MacPherson,* 111 N.E. at 1052 (quoting Heaven v. Pender 11 Q.B.D. 503, 510 (1883)).

31. *Id.* at 1053.

Indeed, ninety years ago Cardozo recognized that limiting these principles to dangerous products was not appropriate. Cardozo noted that, whatever the limitation in the *Thomas* decision may have been, the holding "has no longer that restricted meaning."[32] Cardozo recognized that application of the principles regarding negligence could change over time.

Cardozo noted that the seller must know that, in the usual course, persons others than the buyer will share the danger. Such knowledge may be inferred from the nature of the transaction.[33] As noted by Cardozo, there is simply no reason why application of these principles cannot change over time:

> Precedents drawn from the days of travel by stagecoach do not fit the conditions of travel today. The principle that the danger must be imminent does not change, but the things subject to the principle do change. They are whatever the needs of life in a developing civilization require them to be.[34]

Cardozo later explored the application of negligence principles to contractual cases causing purely economic damage in *Glanzer*[35] and *Ultramares*.[36] The key question is whether principles and precedents drawn from the days of one-on-one services, when buyers purchased services directly from companies without the use of middlemen such as brokers and accountants, fit the conditions of today where there is an increasing number of parties between the creation of product or service and its final purchase by an end user. While *Glanzer* supports the application of the foreseeability principle to economic damage caused by a third party's negligent preparation of a report[37] – thus expanding the scope of duty beyond the notion's traditional bounds – the accepted interpretation of *Ultramares* limits the application of this rule.[38] Ultimately, however, a close review of both decisions demonstrates that

32. *Id.* at 1052.

33. *Id.* at 1052-53. This principle will be explored in depth later in this article by analyzing the application of negligence principles to service providers that negligently prepare documents to be used by third parties, resulting in economic injury. *See* discussion *infra* pp. 19-24.

34. *MacPherson*, 111 N.E. at 1053.

35. Glanzer v. Shepard, 135 N.E. 275 (N.Y. 1922).

36. Ultramares Corp. v. Touche, 174 N.E. 441 (N.Y. 1931).

37. *See* 135 N.E. 275, 276 (N.Y. 1922).

38. *See* 174 N.E. 441, 448 (N.Y. 1931).

the limitation imposed by *Ultramares* should be the exception, not the rule. Before discussing *Glanzer* and *Ultramares*, I will begin with a discussion of the seminal case concerning duty and foreseeability, *Palsgraf v. Long Island R.R. Co.*[39]

2. *Palsgraf*

The facts of *Palsgraf*[40] are well known by any first-year law student and need not be repeated in depth here. Briefly, an unidentified man was attempting to board a Long Island Railroad train as the train was leaving the station.[41] When an employee of the railroad pushed the man onto the train, a newspaper-wrapped package that the man was carrying fell to the tracks. The package contained fireworks, which exploded on impact, causing several scales on the platform to fall over, one of which injured Mrs. Palsgraf.[42] Mrs. Palsgraf sued the Long Island Railroad for negligence.[43] The question was whether the railroad owed a duty to Mrs. Palsgraf in its conduct towards the unidentified man. The Court of Appeals, in a 4-3 decision, held that the railroad did not owe such a duty.[44]

Writing for the majority, Cardozo began by noting that negligence is the absence of due care according to the circumstances.[45] In addition, the negligence must be specific to the party injured.[46] Thus, if no hazard to a third party was apparent to a person of ordinary diligence, an act does not become a tort simply because it happened to result in an injury.[47] There must be a specific duty to the injured party, not a general duty to the world at large.[48]

> "Negligence, like risk, is thus a term of relation. Negligence in the abstract, apart from things related, is surely not a tort, if indeed it is understandable at all. Negligence is not a tort unless it results in the com-

39. 162 N.E. 99 (N.Y. 1928).
40. Palsgraf v. Long Island R.R. Co., 162 N.E. 99 (N.Y. 1928).
41. *Id.* at 99.
42. *Id.*
43. *Id.*
44. *Id.* at 101.
45. *Id.* at 99.
46. *Id.*
47. *Id.*
48. *Id.* at 100.

> mission of a wrong, and the commission of a wrong imports the violation of a right . . .[49]

Thus, Cardozo set out the principle that a party is liable if they commit a wrong against an individual entitled to protection.[50] There is no logical reason why this principle should be limited to personal injury. A duty should be owed to all foreseeable parties who are injured by negligent conduct, even if the injury is purely economic.

C. *Duty In Economic Injury Cases*

1. *Moch*

In *Moch v. Rensselaer Water Company*, decided four months prior to *Palsgraf*, the court took a cautious approach to the potential liability of a private water company.[51] The defendant had a contract with the City of Rensselaer to supply water for, among other purposes, service at fire hydrants.[52] Pursuant to the agreement, water would be furnished to private takers at reasonable rates.[53] While the contract was in force, a fire occurred that spread to the plaintiff's warehouse; the plaintiff alleged that the defendant neglected to supply water with sufficient pressure to combat the fire.[54] The question raised was whether the defendant owed a duty to the plaintiff.[55] The court, again led by Cardozo, said "no."[56]

Cardozo was clearly concerned about the consequences of imposing unlimited liability on a public utility company. "We are satisfied that liability would be unduly and indeed indefinitely extended by this enlargement of the zone of duty."[57] In *Moch*, the building that was connected to defendant's water supply was not owned by the plaintiff; the plaintiff was the owner of the building to which the fire spread.[58] In addition,

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49. *Id.* at 101 (citations omitted).

50. Of course, some acts give rise to liability to anyone that may be injured, such as strict product liability, etc. However, for the purposes of this paper, we are limiting our discussion to acts of negligence.

51. 159 N.E. 896.

52. *Id.* at 896.

53. *Id.*

54. *Id.* at 896-97.

55. *Id.* at 897.

56. *Id.*

57. *Id.* at 899.

58. *Id.* at 896.

the water company did not directly cause any damage.[59] Although not stated in the opinion, this may be considered a proximate cause case in which the court was making a policy determination as to the extent of liability of a negligent actor.[60]

In addition, this case falls squarely within today's application of the duty of public entities, such as police and fire departments. Governmental departments have no general duty to the public at large. A water company, a quasi-public entity, should arguably have the same protections, and thus would only owe a duty for damages caused by its failure to perform its contractual obligations with respect to those to whom the entity owes a special duty. Cardozo may have been thinking about the potential unlimited exposure to the public at large unless some limitation was applied.

2. *Glanzer*

Glanzer, decided in 1922, six years before *Palsgraf*, applied negligence principles to contract cases involving purely economic injury to determine whether a contractor was liable to third persons for negligently performed duties.[61] *Glanzer* involved a three-party relationship: the plaintiff-buyer contracted to purchase beans from the defendant-seller; the seller had in turn contracted with a public weigher for the purposes of the sale in question. *Glanzer* addressed the potential liability of that public weigher.[62]

The court found the weigher liable for the purchaser's damages.[63] Significant in the court's decision was the direct contact between the public weigher and the plaintiff. Indeed, the weigher communicated directly with the plaintiff to ascertain whether the shipment was in order.[64] Furthermore,

59. *See id.*

60. *Id.* at 897 (stating that the benefit derived from a public entity "must be primary and immediate in such a sense and to such a degree as to bespeak the assumption of a duty to make reparation directly to the individual members of the public if the benefit is lost. The field of obligation would expand beyond reasonable limits if less than this were to be demanded as a condition of liability.").

61. Glanzer v. Shepard, 135 N.E. 275 (N.Y. 1922).

62. *Id.* at 275.

63. *Id.* at 277.

64. *Id.* at 275.

"[t]he plaintiffs' use of the [weight] certificates was not an indirect or collateral consequence of the action of the weighers. It was a consequence which, to the weighers' knowledge, was the end and aim of the transaction."[65]

Thus, the idea of foreseeability was apparently on Cardozo's mind in *Glanzer*. While *Glanzer* dealt with purely economic loss rather than bodily injury, the court clearly noted that it was foreseeable that a mistake in the weighing would directly injure the plaintiff.[66] Cardozo, hinting at the foreseeability standard that was to come, noted that "[c]onstantly the bounds of duty are enlarged by knowledge of a prospective use."[67]

3. *Ultramares*

Ultramares involved an accounting firm that prepared an audit for a client.[68] Unbeknownst to the defendant accounting firm, the client used the audit to obtain loan guarantees.[69] The audit was negligently prepared, and the plaintiff, a company that was harmed by the negligent audit, sued the accounting firm.[70] The New York Court of Appeals held that plaintiff did not have a cause of action sounding in negligence.[71]

The court in *Ultramares* was clearly concerned about foreseeability. The court was concerned that permitting recovery by a plaintiff not known to the accounting firm would expand the duty of accountants to a class of people both unforeseeable in number and existence. The court thus posed the fundamental question:

> We have brought to the question of duty, its origin and measure to creditors and investors to whom the employer exhibited the certificate, 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. A differ-

65. *Id.*
66. *Id.* at 275-76.
67. *Id.* at 276 (citations omitted).
68. Ultramares Corp. v. Touche, 174 N.E. 441 (N.Y. 1931).
69. *Id.* at 442.
70. *Id.* at 443.
71. *Id.* at 448-49 (holding that an action in fraud may sound).

> ent 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 *undetermined 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.[72]

The court also examined its recent decision in *Glanzer.* The court observed that in *Glanzer* there was something more than a report prepared for a specific buyer.[73]

> Here was something more than a rendition of a service in the expectation that the one that ordered the certificate would use it thereafter in the operations of his business as occasion may 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 of a transaction," as certain and immediate and deliberately willed as if a husband would to order a gown to be delivered to his wife, or a telegraph company, contracting with the sender of a message, were to telegraph it wrongly to the damage of the person expecting to receive it.[74]

The court then concluded that a duty did not arise to unidentified and indeterminate (unforeseeable) third parties relying on an audit report where the defendant did not know that the contracting party would hold it out for such use.[75]

The *Glanzer* and *Ultramares* cases can be reconciled by appeal to the concept of foreseeability. If the class of potential plaintiffs is foreseeable and definable, the contracting party should owe a duty to third parties. In determining when a contracting party owes a duty to a third party, courts have held that the contracting party owes a duty to the third party when

72. *Id.* at 444 (emphasis added) (citations omitted).
73. *Id.* at 445.
74. *Id.* (citations omitted).
75. *Id.* at 446.

the relationship approaches privity.[76] However, courts analyzing this "functional equivalently of privity" test have often held that such conditions do not exist.[77]

The New York Court of Appeals later reaffirmed the *Ultramares* standard in *Credit Alliance Corp. v. Arthur Anderson & Co.*[78] The Court held:

> Inasmuch as we believe that a relationship "so close as to approach that of privity" remains valid as the predicate for imposing liability upon accountants to non-contractual parties for the negligent preparation of financial reports, we restate and elaborate upon our adherence to that standard today.[79]

III.
THE *ULTRAMARES* STANDARD

The standard promulgated in the *Ultramares* case has been reviewed in courts in virtually every state in the country.[80] One question to ask is whether *Ultramares* would have been decided differently if the accountant defendants knew the purpose for which the audit was being prepared. If the accountants knew that the report would be shown to various entities to secure the financing and that those entities would rely on the audit, the "end and aim" of the transaction would have been to secure funding, and it would then have been foreseeable that an identified class of persons could be harmed if the audit was negligently prepared.[81] Under these facts, the court may well have held that the damaged lenders could seek recovery from the accountants.

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76. *See id. See also* Credit Alliance Corp. v. Arthur Anderson & Co., 483 N.E.2d 110, 119-20 (N.Y. 1985).

77. *See, e.g., Credit Alliance,* 483 N.E.2d at 119-20; Jacobs v. Kay, 857 N.Y.S.2d 81 (App. Div. 2008); Bri-Den Const. Co. v. Kapell & Kastow Architects P.C., 867 N.Y.S.2d 437 (App. Div. 2008); Lusins v. Cohen, 853 N.Y.S.2d 685 (App. Div. 2008); Point O'Woods Ass'n v. Lloyds, 733 N.Y.S.2d 146 (App. Div. 2001). *But see* Kidd v. Havens, 577 N.Y.S.2d 989 (App. Div. 1991).

78. 483 N.E.2d 110, 118 (1985).

79. *Id.* at 115.

80. *See e.g.,* Colonial Bank of Ala. v. Ridley & Schweigert, 551 So. 2d 390 (Ala. 1989); First Fla. Bank v. Max Mitchell & Co., 558 So. 2d 9 (Fla. 1990); Rozny v. Marnol, 250 N.E.2d 656 (Ill. 1969).

81. *See Glanzer,* 135 N.E. at 275; *Ultramares* 174 N.E. at 445.

Put another way, *Ultramares* may simply stand for the proposition that when a contractor such as an accountant, broker, lawyer, or real estate agent is hired to prepare a general report without specific knowledge of what the report will be used for, the contractor that negligently performs its hired task has no duty to unidentified third parties. Cardozo's reliance upon privity may have been nothing more than the term of the times. At the time *Ultramares* was decided, privity was king. Indeed, *Ultramares* was not a limitation of liability to third parties, but an expansion. The court implied that strict privity was no longer required for the contractor to face liability to third parties, if there was a "bond . . . so close as to approach that of privity. . . ."[82] While the characteristics of that bond were left unidentified, Cardozo was working within the "citadel of privity"[83] and was thus constrained by the times to act cautiously. Cardozo did not change the principles of law; he merely changed their application.[84]

The accepted *Ultramares* rationale, that privity is necessary for liability to third parties, has been described as the "majority" rule, but it is not without criticism.[85] However, much of this criticism is based on the traditional interpretation requiring privity for liability to third parties.[86] If *Ultramares* were interpreted as a foreseeability case, much of the criticism would become moot.

As noted above, Cardozo was a great influence regarding the concepts of duty, privity, and foreseeability in the early twentieth century.[87] Cardozo essentially created the current concept of duty as it is generally known in the United States. However, he was working in a confined environment, shackled by outdated concepts that he intended subtly to rework without alerting anyone to the fundamental changes he was advancing. In a series of cases, Cardozo essentially eliminated

82. *Ultramares*, 174 N.E. at 446.

83. *Id.* at 445.

84. *See* MacPherson v. Buick Motor Co., 111 N.E. 1050, 1053 (N.Y. 1916) ("The principle . . . does not change, but the things subject to the principle do change.").

85. *See, e.g.*, Kohala Agric. v. Deloitte & Touche, 949 P.2d 141 (Haw. Ct. App. 1997).

86. *See, e.g.*, *id.*

87. *See, e.g.*, *Ultramares*, 174 N.E. 441; Moch v. Rensselaer, 159 N.E. 896 (N.Y. 1928).

the privity standard in bodily injury cases.[88] In addition, Cardozo greatly expanded who can recover absent privity in purely economic cases.[89] However, this expansion has often been misinterpreted as a restriction.

While there seems to be a distinction between cases involving purely economic loss and those cases involving bodily injury, there is no need for such a distinction. This distinction is most clearly expressed in the Restatement (Second) of Torts. The Restatement Section 324A provides:

> One who undertakes, gratuitously or for consideration, to render services to another for which she should recognize as necessary for the protection of a third person or thing, is subject to liability to the third person for physical harm resulting from his failure to exercise reasonable care to protect his undertaking if
>
> a) his failure to exercise reasonable care increases the risk of harm, or
> b) he has undertaken to perform a duty owed by the other to the third person, or
> c) the harm is suffered because of reliance of the other or third person upon the undertaking.[90]

Section 552, however, limits liability regarding negligent business transactions that cause delay or economic damage. It provides in part:

> (2) Except as stated in Subsection (3), the liability stated in Subsection (1) is limited to loss suffered
> (a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; or
> (b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.[91]

88. *See, e.g.*, Palsgraf v. Long Island R.R. Co., 162 N.E. 99 (N.Y. 1928).
89. *Id.*
90. RESTATEMENT (SECOND) OF TORTS § 324A (1965).
91. *Id.* § 552.

However, there is no need for such distinctions. The same notion should apply whether the injuries resulted in bodily injury or purely economic damage. As argued below, this should be the logic adopted by the Restatement Section 552, applying foreseeability to a specifically identified group of people whom the contracting party intended to benefit. As noted by Cardozo, "Because the danger is to be foreseen, there is a duty to avoid the injury."[92] When either economic or bodily injury is foreseeable to a specific class of people whom the contracting party intended to benefit, there is no basis for denying potential liability merely because of a lack of privity. As noted by the *MacPherson* court, a duty arises to use ordinary care and skill for the supply of goods if one could recognize the foreseeable danger of negligent performance.[93]

In the information provision context, a duty to use ordinary care and skill will arise where a) a party supplies information for use by another party; b) the supplier knows how the information will be used; c) a reasonable person would recognize that the lack of ordinary care and skill could lead to significant economic losses.[94]

Of course, courts have an obligation to constrain the potential for unlimited liability and often take a paternalistic role in defining and implementing limits of liability.[95] While there are certainly some instances where this is appropriate, such limitations are often neither helpful nor fair in a typical case involving either bodily injury or economic injury caused by a contracting party.

When a contracting party performs a service, the costs of that service should and often do account for costs arising from insurance coverage and potential liability. As long as the contracting party is aware of the potential ramifications of negligent performance, the contracting party will be able properly to determine the price it must charge the other party. This is true whether liability is limited by the concept of privity or whether it is open to all foreseeable people. All bidders on the

92. Machperson v. Buick Motor Co., 111 N.E. 1050, 1051 (N.Y. 1916).

93. *Id.* at 1052.

94. *Id.*

95. *See e.g.*, Robinson v. Benton, 842 So. 2d 631 (Ala. 2002); Calloway v. City of Reno, 993 P.2d 1259 (Nev. 2000); Western S.S. Lines, Inc. v. San Pedro Peninsula Hosp., 876 P.2d 1062 (Cal. 1994).

contract will be faced with the same potential liability for negligent conduct.

The question is who should bear ultimate liability for the negligent performance of a contract. Privity, by limiting liability to those contracting with one another, places the responsibility on the party that hired the negligent actor. Thus, a non-negligent actor may be forced to pay an injured third party because of the negligent conduct of his sub-contractor. This seems inappropriate under the current concept of tort liability.

IV.
CONTRACTUAL LIABILITY TO THIRD PARTIES

There are three primary theories used to resolve the question of whether a contracting party is liable to third parties for purely economic damages. The first is the traditionally accepted analysis of *Ultramares* requiring privity, although this approach has generally been modified to permit liability if there is the functional equivalent of privity.[96] The second theory is the reasonable foreseeability theory, where all parties who are reasonably foreseeable recipients of the information can recover, if they rely on the information.[97] The third and final theory was promulgated in the Restatement Section 552(1)-(2). This theory is an intermediate approach that permits recovery by the class of persons the contracting party knew or should have known would rely upon the information contained in the report:

> Although it is sometimes difficult to discern the differences between the [three] approaches, appropriate lines can be drawn between the respective *Ultramares Corp., Credit Alliance Corp. v. Arthur Anderson & Co.*, and Restatement approaches and the nonrestrictive foreseeability approach. For example, although the Restatement's approach extends liability to a larger potential class of third parties than do the *Ultramares Corp.* and *Credit Alliance Corp.* approaches, it does not extend liability beyond an identified third

96. Credit Alliance Corp. v. Arthur Anderson & Co., 483 N.E.2d 110, 118-19 (N.Y. 1985) (permitting recovery where the relationship is "sufficiently approaching privity").

97. *See* H. Rosenblum, Inc. v. Adler, 461 A.2d 138, 153 (N.J. 1983).

party, a known third party, or third parties who enter into some type of transaction as originally contemplated. In other words, under the *Ultramares Corp.* and *Credit Alliance Corp.* approaches, "the precise identity of the informational consumer [must] be foreseen by the auditor," but under the Restatement approach, the precise "informational consumer" need not be known; rather the Restatement approach "contemplates identification of a narrow group, not necessarily the specific membership within that group." Moreover, unlike the foreseeability approach, the Restatement approach does not extend to "every reasonably foreseeable consumer of the financial information."[98]

Section 552 of the Restatement provides in part:

(1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, 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 confidence in obtaining or communicating the information.

(2) Except that stated in Subsection (3), the liability stated in Subsection (1) is limited to loss suffered
   (a) by the person or one in a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and
   (b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.

(3) The liability of one who is under a public duty to give information extends through loss suffered by any other class of persons whose benefit the

98. Ellis v. Grant Thornton LLP, 530 F.3d 280, 288 n.5 (4th Cir. 2008) (citations omitted).

> duties create, in any other transactions intended to protect them.[99]

Thus, under the Restatement, a contracting party is liable to non-parties for negligence if the contracting party knows that the other contracting party intends to rely upon it or if the person belongs to a limited group for whose benefit or guidance the contracting party intends to supply the information.[100]

At least one court has noted the distinction between the *knowledge* that a third-party will rely upon the opinion and the *possibility* that others may rely upon it.[101] The Indiana Supreme Court held that mere foreseeability was not enough to overcome the privity standard. There must be knowledge or an expectation that others may rely upon it.[102] This application makes sense in that it permits recovery by injured third parties but limits a contracting party's exposure appropriately.

The theories were analyzed in depth by the Hawaii Court of Appeals in *Kohala Agriculture v. Deloitte & Touche.*[103] The court began by noting that there are three doctrines regarding potential liability for a third party's economic loss: (1) privity; (2) foreseeability; and (3) the Restatement Section 552.[104] The court then analyzed the standard set by Cardozo in *Ultramares*, finding that that court upheld the privity concept. However, the court also noted that, in *Credit Alliance*, the New York Court of Appeals modified the standard for finding that a relationship is "so close as to approach that of privity."[105] The court reviewed the three-part test adopted in *Credit Alliance* for determining when a third party not in privity may seek recovery for their reliance on negligently prepared financial reports, whose elements are as follows: (1) the contracting party

99. RESTATEMENT (SECOND) OF TORTS § 552 (1965).

100. *Id.*

101. Thomas v. Lewis Eng'g, Inc., 848 N.E.2d 758, 760 (Ind. 2006) (citing Essex v. Ryan, 446 N.E.2d 368 (Ind. Ct. App. 1983)) (holding that mere foreseeability is not enough; there must be contact between the professional and the third party).

102. *Id.*

103. 949 P.2d 141 (Haw. Ct. App. 1997).

104. *Id.* at 155 n.26 (noting that variations of these doctrines have been adopted in other states).

105. Credit Alliance Corp. v. Arthur Anderson & Co., 483 N.E.2d 110, 115 (N.Y. 1985).

must be aware that the financial reports will be used for a particular purpose or purposes; (2) a known party or parties is intended to rely thereupon; and (3) there must be some conduct by the contracting party linking them to the third party which evidences the contracting party's understanding of the third party reliance.[106]

The *Credit Alliance* test led to the enlargement of the three original theories into four. Those four theories are: the privity requirement in *Ultramares*; the three-part test from the *Credit Alliance*; the Restatement Section 552 test; and the reasonable foreseeability approach.[107] The *Kohala* court analyzed the Restatement's Section 552 approach, noting that it was deliberately restrictive to encourage the exchange of commercial information.[108] According to the court, the Restatement's approach also seeks to protect suppliers of commercial information from liability in instances in which they obliged themselves to provide information but the terms of that obligation are unknown to them.[109]

In 1992, the Supreme Court of California analyzed the various approaches in *Bily v. Arthur Young & Company*.[110] In that case, the California court noted that at least nine states followed the privity or near-privity rules adopted by the New York courts in *Ultramares* and *Credit Alliance*.[111] In five states, the results were reached by decisions of a higher court, and in four states the results were reached by statute.[112] Most of these states used the reformulated near-privity approach adopted by *Credit Alliance*.[113]

The court noted that, in ten states where the foreseeability approach has been proposed at least four states had explicitly rejected a pure foreseeability approach in favor of the Restatement's "intended beneficiary" approach.[114] The foreseeability approach, the court pointed out, has not attracted a

106. Ellis v. Grant Thornton LLP, 530 F.3d 280, 287-88 n.4 (4th Cir. 2008).
107. *Id.* at 287-88.
108. 949 P.2d at 161.
109. *Id.*
110. Bily v. Arthur Young & Co., 834 P.2d 745 (Cal. 1992).
111. *Id.* at 755.
112. *Id.*
113. *Id.*
114. *Id.* at 771

substantial following.[115] The court indicated that the Restatement approach enjoyed somewhat more support than the privity rule and much more support than the foreseeability rule, with at least seventeen states and federal decisions endorsing the rule.[116]

Analyzing the five opinions by Cardozo and the more recent approaches to this issue, I would argue that today Cardozo would adopt the Restatement approach. Indeed, the Restatement approach combines Cardozo's two most important principles: foreseeability and protection from unlimited liability. *Glanzer* and *MacPherson* demonstrate Cardozo's willingness to abandon, or at least significantly modify, the privity requirement and permit recovery by foreseeably injured third parties. *Palsgraf*, *Moch*, and *Ultramares* demonstrate Cardozo's concern about unlimited liability arising from a specific contract or conduct. The *Restatement* approach combines these principles. Privity is not required, but liability is limited to the class of parties that is specifically foreseeable. Simply put, there should be one standard of duty in tort cases – foreseeablity – limited to the class of entities that a contracting party intends to influence or benefit. This should be true whether the injuries are bodily injury, property damage, or purely economic.

V.
CONCLUSION

Judges are sometimes insulated from the practical realities of the real world. Courts are sometimes behind the times in adjusting to changing circumstances. In addition, courts sometimes stick with opinions and decisions that, while cutting-edge when made, have long outlived their usefulness.

The reality of business in the twenty-first century and all of its technological advances require courts to adapt. When dealing with the concept of duty and adhering to the privity concept, courts are still locked into the nineteenth century. Even if courts insist on looking back to opinions that are nearly 100 years old for support, however, there too they can find authority for the foreseeability concept when assessing the duty owed by contracting parties to third parties. Businesses

115. *Id.* at 757.
116. *Id.* at 758-59.

must adapt to changing circumstances to survive, and courts must keep up with changing circumstances in order to ensure that both business and the courts run smoothly.

Taking together the five opinions authored by Judge Cardozo nearly 100 years ago, we can form a reasonable principle for all negligence cases. If a party knows, or should know, that another party will rely upon its performance, the performing party should be liable to all such foreseeable parties for negligent performance. The exposure should be based on the known risk. For example, an accountant who performs an audit that the accountant is told should only be used internally will not owe a duty to any other party. If the accountant knows or should know that the audit will be used to secure financing, the accountant should owe a duty to the banks and lenders to whom the audit is provided for the financing. If the accountant knows or should know that the audit will be used for an IPO, the accountant should owe a duty to all potential investors. While this may lead to a virtually unlimited exposure in some circumstances, the accountant would be aware of this exposure and could take appropriate precautions and increase the price of his services accordingly.

Thus, we have the rule: a contracting party owes a duty to all entities it knows or should know will rely upon the services provided. This principle should be applied whether the damages are for personal injury, property damage, or pure economic loss. This is a simple standard of care that can be applied to any negligence case. While privity remains for now, perhaps it should be put to rest.