NY Federal Court Rules Auditors Strictly Liable for Their “Opinions”

by Michael Cifelli on September 23, 2013

Ernst & Young and PriceWaterhouseCoopers will not be dismissed from the securities class-action lawsuit involving Overseas Shipholding Group, Inc. (OSG). The two firms provided auditing services to the now defunct company.

The case revolves around OSG’s public offering of three hundred million dollars of unsecured notes. In connection with the transaction, OSG filed a Shelf Registration Statement and Prospectus that allegedly failed to disclose tax liability under Section 956 of Section F of the Internal Revenue Code.

Both Ernst & Young and PriceWaterhouseCoopers signed the Registration Statement. They also “expressly consented to having their unqualified audit opinions for OSG’s financial statements [for years 2007 through 2009] incorporated by reference into the Registration Statement.” OSG later filed for bankruptcy, which included an Internal Revenue Service claim of $35 million in unpaid corporate taxes.

Under Section 11 of the Securities Act, purchasers of registered securities are afforded strict liability protection where “any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading.” Experts like accountants may specifically be held liable if they certified any part of the Registration Statement containing actionably false information or “prepared any report or valuation used in connection with the registration statement.”

However, with regard to “matters of belief and opinion,” Section 11 liability applies only where the statement was “both objectively false and disbelieved by the defendant at the time it was expressed” under the recent precedent established in Fait v. Regions Financial Corp. In the current case, Ernst & Young and PriceWaterhouseCoopers argued that Fait’s subjective disbelief standard should apply to their auditing “opinions.” However, the court disagreed.

As explained in Judge Shira Scheindlin’s opinion, “Although the Internal Revenue Code is complex and often gives rise to debate, it cannot be said that statements of income tax liability are ‘subjective valuations.’ There is in fact an objective measure of income tax liability, as evidenced by OSG’s public declaration that its financial statements should ‘no longer be relied upon,’ as well as the IRS’s Proof of Claim in OSG’s bankruptcy proceedings.”

Judge Scheindlin further rejected the auditors’ assertion that the entire Audit Opinion is a statement of belief or opinion under Fait because it contains the word “opinion” in its title, and prefaces its conclusions with the phrase “in our opinion.”

"[I]t would render Section 11 meaningless to find that an accountant's liability turns on this semantic choice. Auditors may not shield themselves from liability under Section 11 merely by using the word 'opinion' as a disclaimer. Plaintiffs are only required to allege subjective disbelief where the statements concern 'inherently subjective' matters rather than 'matters of objective fact,'" she concluded.

If you have any questions about this case or would like to discuss the legal issues involved, please contact me, Michael Cifelli, or the Scarinci Hollenbeck attorney with whom you work.