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Oral contracts increase accountants' exposure to breach of duty claims

BY JOHN J. BARBER

John J. Barber is a partner at Tabet, DiVito & Rothstein LLC. He focuses his practice on litigating tax, professional liability, insurance coverage and complex commercial disputes. He can be reached atjbarber@tdrlawfirm.com.

Lawsuits against accountants often include claims for breach of fiduciary duty. Accountants commonly defend against such claims by asserting that a written contract or engagement letter defines their duties, limits their obligations and precludes breach of fiduciary duty claims. A recent Illinois Appellate Court decision — *Miller v. Harris*, 2013 IL App (2d) 120512 (filed Feb. 21, 2013) — cautions accountants that performing work under oral agreements may increase their exposure to breach of fiduciary duty claims.

William Miller and Michael Harris founded a closely held insurance adjusting business, Claimsco International Inc., pursuant to a 1990 shareholders' agreement. *Miller*, 2013 IL App (2d) 120512, ¶ 4. John Verchota and his accounting firm, Miller Verchota Inc., provided accounting services to Miller, his wife, Harris and Claimsco under several oral agreements, beginning in 1990. Id., ¶¶ 5-6.

In 2002, more than 10 years into this arrangement, Harris asked Miller to attend a meeting. Id., ¶ 9. At that meeting, Harris and a lawyer told Miller that the accountant had determined that Miller personally owed Claimsco "a great deal of money." Id. Harris and the lawyer told Miller that they would see to his "financial and personal downfall" unless he executed a new shareholders' agreement, under which Miller would cede majority ownership and control of Claimsco to Harris. Id. Miller signed the new, 2002 shareholders' agreement, but continued to own shares in and work for Claimsco. Id.

In 2007, Harris terminated the 2002 shareholders' agreement, eliminating Miller's remaining ownership interest and participation in Claimsco. Id., ¶ 12. At the same time, the accountant withdrew from his role as personal accountant for Miller and his wife while continuing as accountant for Harris and Claimsco. Id.

Miller and his wife filed a complaint against the accountant, Harris and others. The complaint alleged only one count against the accountant, which the trial court dismissed for failure to state a claim. Id., ¶13. The Millers settled their claims against the other defendants and appealed the dismissal of their claim against the accountant. Id.

The complaint alleged that the accountant orally agreed to use his best efforts to minimize taxation and avoid any conflict of interest. Id., ¶¶ 6-7. After Miller signed the 2002 shareholders' agreement, the accountant allegedly ignored his conflict of interest, adjusted Claimsco's books and records to maximize the Millers' financial liabilities, falsely reflected income to the Millers and improperly prepared the Millers' personal tax returns. Id., ¶¶ 11-12.

The accountant argued that he had agreed to follow the terms of the 2002 shareholders' agreement, which was attached to the complaint and controlled over the complaint's allegations. Id., ¶17. In response, the Millers argued that a fiduciary relationship arose from the accountant's oral agreements to serve as the Millers' personal tax accountant and as Claimsco's accountant and that the accountant breached his fiduciary duty to the Millers. Id., ¶ 20.

Although the Millers titled their claim as one for "accountant malpractice," the appellate court looked "to the substance of the allegations rather than the title" and treated it as a claim for breach of fiduciary duty. Id., ¶ 29.

The court analyzed the breach of fiduciary duty claim by primarily relying on *Khan v. Deutsche Bank AG*, 2012 IL 112219, ¶¶ 48-54 (filed Oct. 18, 2012), which found that breach of fiduciary claims were improperly dismissed.

In reliance on *Khan*, the court first found that the alleged fiduciary relationship between the Millers and the accountant arose as a matter of law from their relationship under the oral agreements. Id., ¶ 19-20. Accordingly, the court held that the 2002 shareholders' agreement did not have control over or negate the complaint's allegations. Id., ¶ 20.

The court next considered whether the complaint stated a claim for breach of fiduciary duty against the accountant by alleging "two elements: a fiduciary relationship and a breach of the duties imposed as a matter of law as a result of that relationship." Id., ¶21 (citing *Khan*, 2012 IL 112219, ¶¶49, 52).

The court held that the complaint alleged a fiduciary relationship between the Millers and the accountant. The complaint alleged that the Millers hired the accountant under an oral agreement "to act as their personal accountant, which included drafting and filing their tax-related documents and providing them with tax advice" and provided the accountant "with confidential financial information and trusted him to minimize their tax liabilities" pursuant to the oral agreement. Id., ¶ 22.

> ***"(A)ccountants should note that working without any agreement defining the engagement terms or under an oral agreement significantly increases litigation risk."***

The court also held that the complaint alleged that the accountant breached his fiduciary duty. The complaint alleged that, beginning in 2002, the accountant placed Harris' interests ahead of the Millers' interests; assisted Harris in gaining control of Claimsco; "used the Millers' personal financial information to harm them; ... and affirmatively acted to keep financial information about Claimsco and necessary tax-related documents from the Millers." Id., ¶ 23.

The appellate court quickly disposed of the accountant's other arguments, including that the fiduciary duty alleged by the Millers could not exist "because any such obligation would run counter to his professional duties and would get him in trouble under the Illinois Public Accounting Act (225 ILCS 450/20.01(a)(14) (West 2010))." Id., ¶27. The court noted that the accountant did not identify "any case law suggesting that the Illinois Public Accounting Act excuses an accountant from his fiduciary duties." Id.

The appellate court held that the complaint stated a cause of action for breach of fiduciary duty against the accountant and therefore reversed the dismissal of the complaint and remanded the case to the trial court. Id., ¶¶ 23-31.

Although a written contract or engagement letter may not provide a bulletproof defense against a breach of fiduciary duty claim, accountants should note that working without any agreement defining the engagement terms or under an oral agreement significantly increases litigation risk.