VICARIOUS LIABILITY – A TANGLED WEB

BY: THOMAS R. MANISERO AND CHRISTINA SALEM

June 24, 2005

Executive Summary

Firms that become members in “Associations” can find themselves trapped in the tangled liability web that is weaved when independent firms hold themselves out to be something more for marketing purposes.

Perhaps the most salient illustration of membership alienation protestation between an accounting firm and its affiliated members/associations can be traced to the current suit between Italian dairy giant, Parmalat SpA, and the U.S. based accounting firm of Deloitte & Touche LLP. Despite classifying itself as a network of affiliated but legally separate national partnerships, each of which is an independent organization responsible for its own actions, with Deloitte & Touche SpA acting merely as its Italian arm, the U.S. unit of Deloitte & Touche finds itself implicated with the massive accounting scandal at Parmalat. U.S. based Deloitte & Touche disavows any liability for acts committed by its Italian counterpart by boldly repudiating accusations of being a single entity with its various networks. Deloitte & Touche maintains its professional and legal independence by arguing lack of common ownership and control among the various local partnerships, with no scheme in place for sharing of profits or personnel.

As the accounting profession is becoming significantly more global in the wake of the expanded world economy, when litigation erupts, accounting groups continue to claim that their units are independent and cannot be held liable for each other’s transgressions. For the most part, courts have accepted this argument.

A significant number of international trade or professional firm associations, also known as networks and alliances, have been formed to expand their members’ markets, share market information, and provide a uniform level of quality services. Commonly, individual members of such associations and the association itself believe that they face no legal liability for the acts of fellow members. Although this generally is a correct belief, there are significant circumstances where individual members of a professional association face legal liability depending upon the business or profit motivation of the association, and the specific activities undertaken by the association or its members.

There is no one specific rule of law that defines association member liability. United States courts, in addition to various international jurisdictions, employ a variety of legal approaches in extending association member liability. Regardless of the different approaches, however, there appear to be no instances where automatic member vicarious liability exists for the acts or omissions of individual members. Special caution, however, should always be exercised in any
communication to third parties giving the appearance that association members are acting on behalf of the association.

This report analyzes the circumstances upon which the members of an association of independent professional firms may be subject to vicarious liability for the acts of an individual member firm. A brief analysis concerning the association’s potential liability for acts of any of its member firms is delineated. Moreover, a brief review of international principles, where available, is presented.

I. Introduction to Association Member Liability

Extension of vicarious liability upon associations for the acts or omissions of its member firms is not a well-developed field of law. Few published court decisions from throughout the United States outlining the elements of such potential liability exist. Considered comprehensively, however, this small body of law provides a reliable guideline for understanding the potential contractual and tort liability professional association members may face for the acts of fellow association members.

Various courts adopt agency law principles and/or partnership by estoppel in determining whether associations or their members are liable for the acts of another member. Many jurisdictions distinguish between associations organized for commercial profit making and those organized for fraternal or social purposes. Members of fraternal associations typically do not face liability for the acts of fellow members unless they are directly involved in the event or circumstance that gives rise to liability. Members of “for-profit” associations may face liability for the acts of fellow members even if they were indirectly involved in the event or circumstance that gives rise to liability.

Various states impose liability on member firms if the member firms participate in, authorize or ratify acts of other member firms. In these circumstances, member firms may face potential liability for acts of other member firms under agency or partnership theories or if they are found to have the requisite level of control over the member firm that commits the wrongful act. At least one court recently has dismissed a claim against an accounting firm association for lack of jurisdictional contacts with a state in which one of its members was being sued. That claim arose under agency principles.

Other recent court decisions have not used “traditional” rules, but instead, have focused on whether the conduct in question meets the legal elements of the claim at issue. In these circumstances, the following two broad rules exist: (1) in order to succeed under a fraud-based claim, the plaintiff must allege and establish that the association and its members had intent to defraud or actual knowledge of the fraud; and (2) in negligence claims, the plaintiff must allege and establish that the association and its members meet the privity or near-privity standards that exist in different forms under the laws of each state. For example, to be held liable in New York, the association and its members must be aware that the member’s work will be used for a
particular purpose, that a third party is relying on that work and there must be some conduct linking the association and its other members to that known party.

Concerning the international treatment of association vicarious liability, the most developed body of law appears to be from England, which tends to adhere to agency rules of law in assessing liability. Namely, liability may be found if the alleged wrongdoer acted with actual or apparent authority to bind the association or its other members.

In light of the various legislative and judicial approaches to association vicarious liability, perhaps the most effective way to manage this potential risk is through the purchase of liability insurance. Although the terms of such coverage need to be carefully examined and negotiated to adequately cover the business of professional associations and their member firms, liability insurance provides the necessary certainty that members’ potential liability is mitigated or eliminated.

II. Unincorporated Associations

There are professional associations for virtually every profession. Professional associations are composed of individuals who have acquired knowledge and experience to qualify them as specialists in performing particular services. Occasionally, membership in a professional association is limited to those who have acquired some specified professional credential.

As a general principle of United States law, an unincorporated association is not an entity, and has no status distinct from the persons composing it. Rather, it is a body of individuals acting together for the furtherance of a common enterprise upon methods and forms used by corporations, but without a corporate charter. While unincorporated associations technically do not exist as legal entities apart from their members, state legislatures may recognize the separate existence of associations by statute. For example, under the Uniform Unincorporated Nonprofit Association Act, a non-profit association is a legal entity separate from its members. In addition, if facts and circumstances warrant, it has been held that an association doing business as a legal entity may not deny its own existence.

The Texas Supreme Court described the difficulty in assessing liability for unincorporated associations by stating that “unincorporated associations have long been a problem for the law. They are analogous to partnerships, and yet not partnerships; analogous to corporations, and yet not corporations; analogous to joint tenancies, and yet not joint tenancies; analogous to mutual

1 JERALD A. JACOBS, ASSOCIATION LAW HANDBOOK, Chapter 2, page 8 (BNA Books 1986).
2 Id. at 9.
3 6 AM.JUR.2d Associations and Clubs § 1 (1964).
4 Id.
5 Uniform Unincorporated Nonprofit Association Act § 6(a).
agencies, and yet not mutual agencies.”\(^7\) Furthermore, once the status of an organization has been identified, “the far more difficult task is delineating the rights and obligations of such groups and their memberships due to the scarcity of case law on the subject.”\(^8\)

### III. Liability Analysis and Legal Developments

The issues of liability of members of an association and of the association itself for acts of an individual member are examined in different ways by the courts. A New York federal court recently examined the elements of various claims against an association and its members, including agency and partnership principles, in its analysis to determine potential liability. Other courts have focused on the distinction between non-profit and for-profit associations to establish liability standards, and the Supreme Court, in 1906, adopted a control approach.

#### A. Nuevo Mundo Holdings v. PricewaterhouseCoopers

In 2004, the United States District Court for the Southern District of New York decided *Nuevo Holdings v. PricewaterhouseCoopers LLP* and dismissed vicarious liability claims against PricewaterhouseCoopers and Arthur Andersen located in New York City on the legal theories of agency, alter-ego and partnership.\(^9\)

Plaintiffs, the Peruvian and Panamanian shareholders and directors of Banco Nuevo Mundo S.A. ("Nuevo Mundo"), a bank organized under Peruvian law, brought an action against PricewaterhouseCoopers LLP ("PWC") and Arthur Andersen LLP ("Andersen"), accounting firms located in New York City. The action arose from the loss that plaintiffs allegedly suffered when the Peruvian government placed Nuevo Mundo into administration. Plaintiffs' sole allegation against the defendants was that Sociedad de Auditoria Medina, Zalvidary Asociados ("Medina") and Collas Dongo-Soria y Asociados ("CDSA"), the two Peruvian accounting firms with which Nuevo Mundo conducted business, operated under the control of Andersen and PWC and were so identified therewith as to make the defendants liable for the actions of Medina and CDSA. Plaintiffs' allegations assert a vicarious relationship between the accounting firms in Peru and their respective defendant affiliates in the United States.

Plaintiffs asserted that CDSA submitted an allegedly unlawful audit report in July 2001 and Medina revised previous audit reports and undervalued Nuevo Mundo's loan portfolio in violation of generally accepted accounting principles, standards and practices. Plaintiffs alleged nine causes of action against the defendants including common law claims for fraud, tortious interference, negligence, malpractice, prima facie tort, RICO claims, breach of contract and punitive damages.

---

\(^7\) Cox v. Thee Evergreen Church, 836 S.W.2d 167, 169 n.3 (Tex.1992).


The court held that mere allegations of an affiliate relationship are insufficient to hold defendants liable for the actions of either Medina or CDSA. The court reasoned that member firms in an international accounting association are not part of a single firm and are neither agents nor partners of other member firms simply by virtue of using the same brand name.\textsuperscript{10} The court cited other decisions declining to treat different firms as a single entity, holding them liable for each other’s acts, simply because they shared an associational name and/or collaborated on certain aspects of a transaction.\textsuperscript{11}

The court also held that absent any allegations of direct liability, in order to hold the defendants vicariously liable for the actions of the Peruvian accounting firms, plaintiffs must allege facts in support of one of the following three relationships: (i) a principal/agent relationship; (ii) an alter-ego relationship; or (iii) a partnership. The court found that the plaintiffs did not specifically allege facts in support of any one of these relationships.

Plaintiffs argued that the defendants and the overall companies overseeing the activities of local affiliates were implicated because there was overall training and supervision of all affiliates. Moreover, peer review meetings were held to assure compliance with the accepted professional standards and ethical requirements of each affiliate’s activities.

Plaintiffs alleged that “… all principals of [Arthur Andersen], wherever they may be, are, or were, partners. As partners, the actions of any one subjects all to liability.” Plaintiffs further alleged its principal/agent allegation: "in addition, we believe that the Peruvian affiliates cloaked with the names respectively of [Arthur Andersen] and [PricewaterhouseCoopers] and under the aegis of the other accounting firms (present and future defendants), are the 'apparent agents' of those latter accounting firms." Plaintiffs proffered an alter-ego argument as the basis for vicarious liability: "moreover, we allege that the corporate veil may be pierced since we have information and so allege that the Peruvian accounting firms are seriously undercapitalized so as to limit liability in an improper manner."

Moreover, Plaintiffs contended that the Peruvian firms were the subsidiaries of the named defendants. Plaintiffs cited U.S. v. Bestfoods, Inc.\textsuperscript{12} for the proposition that the defendants, their worldwide overseers and the local affiliates were integrated for purposes of achieving good accounting practices, in addition to symbiosis of the companies. The Supreme Court in

\begin{itemize}
\item \textsuperscript{10} Id. (citing In re Lernout & Hauspie Sec. Litig., 230 F. Supp.2d 152, 170 (D. Mass. 2002)).
\item \textsuperscript{11} See In re Lernout, 230 F. Supp.2d at 170-71 (D.Mass.2002) (rejecting theory that KPMG entities should be held jointly and severally liable for each other's acts and statements because they hold themselves out as a single entity); In re AM Int'l Inc. Sec. Litig., 606 F. Supp. 600, 607 (S.D.N.Y. 1985) (dismissing complaint against PriceWaterhouseCoopers entities outside the U.S. after rejecting argument that all PricewaterhouseCoopers affiliates worldwide were "in fact one entity, and acted as agents of one another"); Reingold, v. Deloitte, Haskins & Sells, 599 F. Supp. 1241, 1249, 1254 n.10 (S.D.N.Y. 1984) (holding that existence of DH&S International, "an organization composed of a large number of affiliated accounting firms," did not prove DH&S was "a single worldwide entity" even though some brochures described DH&S as "a single cohesive worldwide organization").
\item \textsuperscript{12} 524 U.S. 51, 118 S. Ct. 1876, 141 L. Ed. 2d 43 (1999).
\end{itemize}
Bestfoods, however, held that activities that involve a subsidiary's facility but which are consistent with the parent corporation's investor status, such as monitoring of the subsidiary's performance, supervision of the subsidiary's finance and capital budget decisions, and articulation of general policies and procedures, should not give rise to direct parental liability.\textsuperscript{13}

The court analyzed each theory alleged by plaintiffs as follows:

\textbf{i. Agency Relationship}

In order to establish a principal/agent relationship, a party must demonstrate the following elements: (1) the manifestation by the principal that the agent shall act for him; (2) the agent's acceptance of the undertaking; and (3) an understanding between the parties that the principal is to be in control of the undertaking.\textsuperscript{14} Actual agency is created by "written or spoken words or other conduct of the principal, which when reasonably interpreted, causes the agent to believe that the principal desires him to so act on the principal's account."\textsuperscript{15} "Whether such an agency exists depends upon the actual interactions of the putative agent and principal and not on the perception a third party may have of the relationship."\textsuperscript{16}

Furthermore, a party must allege that "the agent acts subject to the principal's direction and control."\textsuperscript{17} The importance of control by the principal is paramount. "There is no agency relationship where the alleged principal has no right of control over the alleged agent."\textsuperscript{18} When the elements of an agency relationship have been proven, the corporation acting as principal will be held liable for the torts committed by the agent while acting within the scope of the agency.\textsuperscript{19}

The court held that plaintiffs' complaint failed to support a bald assertion that an agency relationship existed between the defendants and their Peruvian affiliates. Plaintiffs made no allegation of a manifestation by either PWC or Andersen that CDSA or Medina were to act on their behalf. Plaintiffs made no allegation that there was an understanding between PWC and

\textsuperscript{13} Id. at 72.
\textsuperscript{14} Id. (citing Restatement (Second) of Agency § 1 cmt. b (1958); Rubin Bros. Footwear, Inc. v. Chemical Bank, 119 B.R. 416, 422 (S.D.N.Y.1990)).
\textsuperscript{15} Itel Containers Int'l Corp. v. Atlanttrafik Express Service Ltd., 909 F.2d 698, 702 (2d Cir. 1990) (quoting Restatement § 26)).
\textsuperscript{17} Shulman Transport Enterprises, Inc. v. Pan American World Airways, Inc., 744 F.2d 293, 295 (2d Cir.1984).
\textsuperscript{18} Morgan Guar. Trust Co. of N.Y. v. Republic of Palau, 657 F. Supp. 1475, 1481 n. 2 (S.D.N.Y.1987); see also Rubin Bros., 119 B.R. at 422 ("No agency relationship can be established where the alleged principal lacks the essential right of control over the alleged agent.") (citing Shulman Transport, 744 F.3d at 295); Lee v. Kim, 1994 U.S. Dist. LEXIS 15275, No. 93 Civ. 8280, 1994 WL 586435, *3 (S.D.N.Y. Oct. 25, 1994) ("Where the principal does not exercise control over the professed agent, no agency relationship exists.").
CDSA or between Andersen and Medina that the U.S. entities were to be in control of the Peruvian entities' accounting services. Furthermore, there were no facts alleged which suggest that the defendants ever participated in the decision as to how the audit reports submitted by CDSA or Medina were completed, and certainly none which would support an inference that the defendants were either aware of, or in fact contributed to, the decision to alter those audit reports.

Plaintiffs solely alleged that they "relied on representations made by [CDSA] that it was part of and operated under the control of [PWC]," and that "[Medina] represented itself, directly, indirectly or implicitly, as Defendant Andersen." The court reasoned that the plaintiffs' agency claim was based on alleged representations not made by the defendants, but made by the defendant's Peruvian affiliates who were not parties to this litigation.

The court reasoned that the plaintiffs' conclusory allegations that Medina and CDSA were "agents" of defendants Andersen and PWC merely because they represented themselves as part of defendants, were insufficient to withstand defendants' motion to dismiss.

**ii. Alter-Ego Claim**

"Alter ego theory" and the doctrine of "piercing the corporate veil" are one and the same under New York law. To pierce the corporate veil under New York law, a plaintiff must prove that: (1) the owner exercised such control that the corporation has become a mere instrumentality of the owner, who is the real actor; (2) the owner used this control to commit a fraud or "other wrong"; and (3) the fraud or wrong results in an unjust loss or injury to the plaintiff. Courts have recognized that the element of control may be predicated upon the concept of equitable ownership. Pursuant to this approach, an individual who "exercise[s] considerable authority over [the corporation] ... to the point of completely disregarding the corporate form and acting as though [its] assets [are] his alone to manage and distribute" may be deemed the equitable owner of the corporation and its assets, notwithstanding the fact that the individual is not a shareholder and does not occupy a formal position of authority.

The court found that plaintiffs made no factual allegations in their complaint that support an alter ego theory for piercing the corporate veil. Outside of their conclusory allegations of control, the complaint was devoid of any factual allegations to support a finding of an alter-ego. Without any supportive factual allegations, plaintiffs failed to allege sufficient facts to avoid dismissal of their alter ego claim.

---

22 See id. at 1051-53.
23 Id. at 1051.
iii. Partnership

Under New York law, the party "pleading the existence of a partnership has the burden of proving its existence."[24] Plaintiffs' claim of vicarious liability on this basis must plead sufficient facts in support of each of the required elements of a partnership.[25] Those elements are 1) the sharing of profits and losses of the enterprise; 2) the joint control and management of the business; 3) the contribution by each party of property, financial resources, effort, skill or knowledge; and 4) an intention of the parties to be partners.[26] The court found that the plaintiffs also failed to allege sufficient facts to establish the existence of a partnership.

This case demonstrates that associations and their member firms must be aware that agency, partnership and alter-ego theories will likely be utilized by a court in assessing vicarious liability against an association or its members.

B. Ernst & Young International and its Bermuda Member Firm

In the Southern District of New York, investors in a New York managed off-shore investment fund brought a securities fraud class action alleging, among other claims, common law fraud and negligence, against the Bermuda accounting firms that served as the Fund's administrators or auditors, as well as the membership associations of the Bermuda entities and American affiliates of the Bermuda entities.[27]

One group of defendants included Ernst & Young International ("EYI"), Ernst & Young Bermuda ("EYB"), Kempe & Whittle Associates Ltd. ("K & W") and Fund Administration Services (Bermuda) Ltd. ("FASB"), all functioning as the investment fund administrators. Plaintiffs alleged that each Ernst & Young entity held itself out and functioned as a “single, unified company that performed administrative services on behalf of the Fund.”[28] EYI functions as a Member Association and organizes the Ernst & Young enterprise from its executive offices in New York. The Articles of Association provide for “coordination and facilitation of the development of global strategies and initiatives...” Moreover, members are urged to “promote an international identity” and to refer work to other members.[29]

Despite this seemingly unified association front, the court dismissed the claims for violation of federal securities law against EYI for failure to state a claim as either a primary violator or under the theory of controlling person liability. The court reasoned that although the plaintiffs alleged

---

[28] Id. at 462.
[29] Id. at 475.
that EYI comprised a part of the global Ernst & Young enterprise, the sole allegation linking it to the fraud was the indication in an offering memorandum that the Fund administrators were affiliates of EYI, which standing alone was insufficient to link EYI to the dissemination of allegedly false statements by the investment fund administrators. In addition, the court found that plaintiffs failed to allege culpable participation by EYI with particularity, thus dismissing the control person liability claims under the securities laws.30

The plaintiffs also asserted state law claims against EYI, including common law fraud, negligence, professional malpractice and aiding and abetting common law fraud and breach of fiduciary duty. The court held that the complaint contained no specific allegations as to the conduct of EYI, apart from the inadequate, generalized references to the Ernst & Young defendants, necessary to satisfy any of the elements of their state law claims. The court further ruled that the plaintiffs failed to plead their claims under agency or partnership by estoppel theories.

In this regard, the court explained that conclusory allegations that the entities are each agents and/or mere departments of the other, that EYI owned and controlled EYB and that EYI’s office in Bermuda is EYB were insufficient to prove actual authority. In addition, the court stated that even though the defendants held themselves out as a single global entity, the complaint did not specify any express or implied communication by EYI to third parties giving the appearance that the Bermuda entities were acting on behalf of EYI as fund administrator.

Moreover, although the plaintiffs alleged that the investors understood from the offering memorandum that an affiliate of EYI would provide services for the fund, the memorandum was a communication by the fund to investors, not from EYI to investors. In addition, an allegation of a general advertising scheme is not sufficient to create apparent authority.31 The court further explained that allegations that EYB and EYI comprise a unified professional services firm that functions as a financially interdependent global partnership, globally allocates certain revenues and expenses, share clients, abide by common operational policies, and use one another to render services in other jurisdictions were insufficient to establish either: (i) that EYI represented itself or consented to another representing it as a “partner in an existing partnership” with any Bermuda entities; or (ii) or that investors gave credit to any representations of partnership in making decisions regarding the fund.32

30 See id. at 485.
31 Id. at 486-487.
32 Id. at 488. What the court did not analyze, however, was whether EYI had independent vicarious liability, the likely reason being that the issue was not raised.
C. Deloitte Touche Tohmatsu and its Bermuda and US Member Firms

Another group of defendants in this New York decision were Deloitte & Touche (Bermuda) ("DTB"), Deloitte Touche Tohmatsu ("DTT"), and Deloitte & Touche LLP ("DTUS"). Plaintiffs alleged that these entities functioned as a "unified, multi-national accounting firm."\(^{33}\)

DTB is a member firm of DTT, a Swiss Verein, with executive offices in New York. The Articles of the Verein detail the Verein's purposes, including:

- to further international alignment, cooperation, and cohesion among the Member Firms; to assure that Member Firms' practices conform to professional standards of the highest quality; to advance the international and national leadership of the Member Firms in rendering Professional Services; and to foster the shared beliefs, mission, and common vision for the Member Firms.\(^{34}\)

Moreover, DTT's Articles direct Member Firms to "align national plans, strategies, businesses, and operations with global plans, strategies, business, and operations" and to contribute toward the Verein's operating expenses and make every reasonable effort to refer business to other Member Firms. The Verein's Board of Directors are to "address global strategies [and] major transactions and to determine the major policies of the Verein."\(^{35}\)

DTT's "Globalization Prospectus," dated April 1999, discusses the goal of becoming a "true global firm." It describes the integration process as evolutionary, having begun in 1989, and proceeding through stages. In a section entitled "Economic Interdependence," the prospectus discusses how aligned practices will "participate in global cost-savings programs to capture savings and facilitate greater uniformity and compatibility throughout the global firm." DTB signed a Global Alignment Resolution in April 1999, pledging to "transform our international organization into a truly global firm." DTB describes itself as "the Deloitte Touche Tohmatsu practice in Bermuda" and boasts of "more than 90,000 people in over 130 countries" delivering "seamless, consistent services wherever our clients operate."\(^{36}\)

In addressing whether DTB was subject to personal jurisdiction in New York, the court stated that the work for the fund was tied directly to the fund Administrator in New York, and impacted United Stated residents, among others. In its analysis, the court pointed out that DTB sent its proposal of professional services to the Fund Administrator in New York. The proposal identified "Deloitte & Touche" as "part of Deloitte Touche Tohmatsu International" with partners and offices worldwide.\(^{37}\) The court further pointed out that to perform its work, DTB

\(^{33}\) Id. at 462.
\(^{34}\) Id. at 489. A Swiss Verein is an entity without an exact legal counterpart in the United States, but which is somewhat akin to an incorporated membership association and is legally distinct from its members.
\(^{35}\) Id.
\(^{36}\) Id.
\(^{37}\) Id. at 490.
relied in part on help from its United States based affiliate.\textsuperscript{38} The court also stated that a DTB partner spoke with and e-mailed a DTUS partner about a report from Bear Stearns regarding discrepancies in the fund.\textsuperscript{39} Ultimately, the court held that DTB thus was subject to personal jurisdiction in New York.\textsuperscript{40}

With respect to the federal securities laws claim against DTT, the court sustained DTT’s argument that plaintiffs failed to adequately allege that DTT itself was a primary violator of the securities laws, and could not rely on allegations against DTUS generally to hold DTT individually liable for securities fraud claims, ultimately granting DDT’s motion to dismiss those claims.\textsuperscript{41} The court reasoned that the use of DTT’s name on the audit reports was undoubtedly of great importance to investors, in order to provide a well-respected international organization's imprimatur on the audits and lending credence to the work of a small, relatively unknown Bermuda entity. Nonetheless, the use of a DTT's name on a document containing misleading information was, by itself, insufficient to satisfy the scienter (or intent) element of the claim.

Plaintiffs did not allege that DTT knew that the audit reports contained false information, and their conclusory allegations were insufficient to infer that DTT was reckless. The complaint did not allege that DTT was even aware of the reports, much less aware that its name and logo were included on the audit reports. There were no allegations that it failed to review or check information that it had a duty to monitor, that it was aware of any danger that the audit reports included misleading information, or that it was on notice of such a potential danger.\textsuperscript{42}

The court also granted DTT’s motion to dismiss the common law fraud claim because plaintiffs failed to allege intent to defraud. The court further dismissed the aiding and abetting common law fraud claim because plaintiffs failed to plead that DTT had actual knowledge of the fraud. It was held that plaintiffs also failed to adequately allege the aiding and abetting claims under a partnership by estoppel theory. While the complaint alleged that each audit report displayed the DTT logo as well as "Deloitte & Touche," it failed to allege either that DTT or anyone with its consent represented that DTT was a "partner in an existing partnership" with DTB, or that investors gave credit to any such representations in making their investment decisions.\textsuperscript{43}

\textsuperscript{38} Id. at 491.
\textsuperscript{39} Id.
\textsuperscript{40} Id. The court considered other factors in conferring jurisdiction. Given the extent to which DTB’s business course was determined by decisions made in New York, it was appropriate to apply New York law to the claims at issue. Once again, the court pointed out in its analysis that jurisdictional discovery revealed DTB to be a member of an International Verein whose global strategy and policies were set in New York. DTB relies on its membership in the Verein to generate business, submits to review by the Verein, and the logo of the Verein's leader, DTT, appeared on each of DTB's audit reports for the Fund. Although not individually determinative, each of these acts served as a basis to find jurisdiction over DTT and its Bermuda member in New York.
\textsuperscript{41} Id. at 493.
\textsuperscript{42} Id.
\textsuperscript{43} Id. at 495.
With respect to the negligence and malpractice claims against DTT, the court held that there was no privity between DTT and the plaintiffs, and no allegation that DTT even knew that its name and logo were used on the specific audit reports at issue. Consequently, there was no substantive communication between DTT and the investors to constitute conduct linking DTT to an identifiable class of persons. The court reasoned that plaintiffs alleging negligent misrepresentation under New York law against a professional with whom they have no contractual relationship—and thus no privity giving rise to a duty—must establish that the accountant must have been aware that the reports would be used for a particular purpose; in furtherance of which a known party was intended to rely; and there must be some conduct by the accountant linking him or her to that known party.  

Concerning DTUS, the court dismissed the securities fraud claims stating that the plaintiffs had not alleged that DTUS made any misstatements on which they relied. In addition, the court found that the common law fraud claim suffered from the same infirmities as plaintiffs’ securities fraud claim because there was no alleged misrepresentation by DTUS upon which plaintiffs reasonably relied. Nor had plaintiffs succeeded in alleging their common law fraud claim against DTUS under an agency argument. Plaintiffs pointed to no manifestation from DTUS to DTB indicating bestowal of authority to DTB, nor to any express or implied communication by DTUS to a third party from which it would be reasonable to infer that DTB had DTUS' authority to perform its audits.

Similarly, the court dismissed the claims for aiding and abetting common law fraud and breach of fiduciary duty against DTUS by applying the same legal rationale as with DTT— that plaintiffs had not alleged that DTUS substantially assisted with perpetration of the fraud. The court also dismissed plaintiffs' negligence, gross negligence and malpractice claims. The plaintiffs contended that investors were entitled to presume that DTUS issued the audits because the reports are signed "Deloitte & Touche" and represented that the audits had been conducted in conformity with U.S. GAAS and GAAP regulations. However, the court stated that neither the Offer Memo nor the audit reports mentioned DTUS or included its logo.

---

44 Id. at 497.
45 Id. at 496.
46 Id.
47 Id. at 497.
D. Practical Applications of the New York Decision

EYI and DTT are all Member Associations of professional accounting firms with executive offices in New York. The purposes of the associations include cooperation and referral of work. However, DTT expressly directs members to align their practices and consolidate Member Firms business and operating plans, while EYI’s members are directed to market themselves as part of an integrated entity.

Associations and their members should assess the risk of meeting the elements of the claims examined by the New York court in finding liability against the association or its members for the acts of an individual member. By examining how the elements of each legal claim applied to DTT, the New York court did not use traditional rules (discussed below) of potential liability involving associations or their members. This is significant because it may now require associations to examine their conduct on a case-by-case, or event-by-event basis.

The New York decision, however, did provide guidance for considering the propriety of an association’s conduct. These principles can be summarized as follows:

(1) In the case of an association’s liability in a potential fraud claim for any member’s wrongful act, allegations against such member are not enough to hold such association individually liable.

(2) In order to succeed in a fraud claim or aiding and abetting a fraud claim, a plaintiff must allege and establish that the association had the intent to defraud or actual knowledge of the fraud.

(3) With respect to negligence, it would seem difficult to establish privity or near-privity between an association and any party suing an association’s member. Therefore, to be held liable, an association must be aware that the member’s work will be used for a particular purpose, that a third party is relying on that work and there must be some conduct linking the association to that known party.

(4) Associations and their member firms must be aware that a court might also apply agency principles and/or partnership by estoppel in deciding whether the association or one of its members is liable for the acts of another member. Special caution should be exercised by an association in any communication it will have with third parties that may give the appearance that a member is acting on behalf of the association.

Finally, the use of a name or logo was not considered dispositive of any legal issue. The use of a common name or logo will, however, be an element in determining jurisdiction of potential liability.
Another United States District Court recently dismissed claims against the international accounting firm network Moore Stephens International (“Moore Stephens”).\(^{48}\) There, the court determined that Moore Stephens did not have sufficient contacts with Utah, where the alleged wrongful conduct occurred, to exercise personal jurisdiction over the association. The underlying Utah case was a class action involving investors seeking to recover their lost investments in an alleged investment scheme instituted by a variety of related entities. The investors alleged that as part of the scheme a company located in the United Kingdom issued a guaranty based on alleged misrepresentations made by an accounting firm located in the Bahamas, and apparently relied upon by the investors.

The two claims against Moore Stephens -- for common law fraud and breach of fiduciary duties - - solely related to the alleged misrepresentations made by the Bahamas accounting firm. The plaintiffs alleged that Moore Stephens either was directly responsible for the misrepresentations or that the Bahamas accounting firm was acting as an agent of Moore Stephens.

Moore Stephens sought to dismiss the complaint on the grounds that the plaintiffs could not demonstrate sufficient jurisdictional contacts between Moore Stephens and the State of Utah, the venue for the pending lawsuit. In support of its motion, Moore Stephens argued that it did not have any contact with the State of Utah and that the plaintiffs could not establish a sufficient agency relationship between Moore Stephens and the Bahamas accounting firm sufficient to confer jurisdiction over Moore Stephens.

Concerning the agency theory of liability, Moore Stephens argued that it did not authorize the Bahamas accounting firm to act on its behalf, it did not exercise any control over that firm, and that the alleged acts were in no way performed by Moore Stephens.

Moore Stephens also argued that because it was not an accounting firm itself, nor did it practice accountancy, it could not be held liable as a principal. Moore Stephens explained that it merely was an association of independent accounting firms whereby member firms were provided with assistance in maintaining high standards of professional services, through quality control review, meetings, conferences, seminars and workshops.

Moreover, pursuant to its membership agreement, the Bahamas accounting firm retained its status as an independent firm that managed its own day-to-day affairs. According to the court papers, the Moore Stephens membership agreement provides that “[t]he terms] shall not, by implication or otherwise, be deemed to create any relationship or obligation or apply to the conduct of any matter except as to the extent stated. The member firms acknowledged that their practices shall in all respect be continued for their own accounts.” The membership agreement apparently also states that one of the principal objectives of Moore Stephens is “the promotion

\(^{48}\) See Bryant v. Mann, 98-cv-784st (D. Utah 2001).
and expansion of the professional practice of each Member Firm through the activities of [Moore Stephens] and by virtue of its professional reputation but without [Moore Stephens] accepting any engagements for its own account.”

In response to the motion, plaintiffs argued that sufficient jurisdictional contacts existed because of written communications from Utah to Moore Stephens whereby Moore Stephens confirmed that the Bahamas accounting firm was a member of its association. Apparently, during the negotiation of the guarantee at issue, one of the plaintiffs sought confirmation of the Bahamas firm’s membership in Moore Stephens. A Moore Stephens representative in London apparently confirmed the membership in a letter sent to Utah.

Ultimately, in an unpublished decision, the Utah Court dismissed the case against Moore Stephens due to insufficient jurisdictional contacts. The court indicated that despite the allegation that plaintiffs relied upon membership or confirmation of membership in issuing the guaranty at issue, Moore Stephens was not subject to personal jurisdiction in Utah.

This decision has many important implications. As a preliminary matter, it confirms that the agency theory of potential liability can be challenged on the grounds that the association itself does not engage in professional practice. Moreover, it renders that limited communications, such as confirmation of membership, will not necessarily subject the association to jurisdiction in every place where member firms may transact business.

A recent federal Massachusetts decision dismissed vicarious and direct claims against the intentional association of KPMG member firms on several legal theories, including the “single entity” theory, joint and several liability and agency concepts. On August 19, 2002, the United States District Court for the District of Massachusetts issued a lengthy decision in a series of consolidated securities fraud class actions brought by investors collectively called In Re Lernout & Hauspie Securities Litigation. The lawsuits involved a dispute over the proper standard for evaluating the liability of an outside independent auditor for alleged accounting fraud by senior officers of a corporation.

The plaintiffs alleged that various affiliated KPMG entities committed accounting fraud at Lernout & Hauspie Speech Products, N.V. ("L & H"), a Belgian speech recognition software corporation. The defendant KPMG entities were KPMG Bedrijfsrevisoven in Belgium ("KPMG Belgium"), KPMG LLP in the United States ("KPMG US"), KPMG in Great Britain ("KPMG UK"), KPMG in Singapore ("KPMG Singapore"), and the international association ("KPMG International") of which the other defendants were all members.

The plaintiffs alleged that KPMG Belgium issued signed, unqualified audit opinions in 1998 and 1999, allegedly with actual knowledge, or reckless disregard, of false and misleading information contained in L & H's quarterly and annual reports. None of the other KPMG

---

defendants signed the audit report, but plaintiffs asserted claims against KPMG UK, KPMG U.S., and KPMG Singapore for providing false audit information and for helping to prepare L & H's financial disclosures. Plaintiffs also named KPMG International as a defendant on a theory of vicarious liability.

All the KPMG entities moved to dismiss the complaints. The court denied the motions by KPMG U.S. and KPMG Belgium and granted the motions by KPMG Singapore, KPMG UK, and KPMG International. The discussion that follows focuses on the arguments relevant to KPMG International.

The plaintiffs raised several arguments to support the theory that KPMG International was vicariously liable for the acts of its members. The first argument can be referred to as the “single entity” theory. Plaintiffs argued that because members of KPMG International held themselves out to the public as a single entity, they should be held jointly and severally liable for each other's acts and statements.

In examining this claim, the court explained that the source upon which plaintiffs relied -- the home page of the KPMG website -- actually contradicted their claim. The home page stated at the bottom that each of KPMG's member firms is a “separate and independent legal entity” and describes itself as such.

The court then reviewed other decisions that addressed the single entity theory of vicarious liability and found as follows:

Several courts have declined to treat different firms as a single entity, holding them jointly and severally liable for one another's acts, simply because they shared an associational name and/or collaborated on certain aspects of the relevant transaction. See In re AM Int'l, Inc. Sec. Litig., 606 F.Supp. 600, 607 (S.D.N.Y.1985) (dismissing complaint against Price Waterhouse entities outside the United States after rejecting argument that all Price Waterhouse affiliates worldwide were "in fact one entity, and acted as agents of one another"); Reingold v. Deloitte, Haskins & Sells, 599 F.Supp. 1241, 1249, 1254 n. 10 (S.D.N.Y.1984) (holding that existence of DH & S International, "an organization composed of a large number of affiliated accounting firms," did not prove DH & S was "a single worldwide entity" even though some brochures described DH & S (U.S.) as "a single cohesive worldwide organization"). Cf. Noonan v. Winston Co., 902 F.Supp. 298, 300 n. 6 (D.Mass.1995) (noting in dicta that defendant was not a legal entity, but "an associational name used by a group of affiliated advertising agencies which are incorporated in different countries"); Howard v. Klynveld Peat Marwick Goerdeler, 977 F.Supp. 654, 660, 662 (S.D.N.Y.1997) (finding, in evaluation of personal jurisdiction, that "public relations materials suggest[ing] that Klynveld is a global firm or an international network of member firms" do not justify a finding of a partnership or agency between Klynveld and Peat Marwick US).
Ultimately, the court held that neither the facts of the case nor the relevant case law lent credence to the “single firm” theory.

The second theory advanced against KPMG International was based upon an agency theory, describing KPMG US, KPMG UK, and KPMG Belgium as KPMG International’s agents. To substantiate the existence of an agency relationship, plaintiffs pointed to:

a) the excerpts from KPMG International's Website and Annual Report to Shareholders describing KPMG International and/or its member entities as a unitary global entity;

b) KPMG's touting, in its Website and Annual Report to Shareholders, of global services or strategies, including "service lines" which are "globally operated"; "global service teams" lead by "global lead partner[s] [that] provide a top-level point of contact"; a "global performance management process" that "determines salary and incentive compensation awards" for "every KPMG employee around the world" and "provides a consistent way to measure the performance of our people worldwide"; and "proprietary, leading-edge tools" used by all member firms including a "Business Measurement Process" audit methodology; and

c) the alleged "co-extensive responsibility" and collaboration among different KPMG entities in conducting audits for L & H, "all under the umbrella name of KPMG," including London-based KPMG U.S. Capital Market Group's review of L & H audits and financial statements to ensure their compliance with U.S. GAAP.

The first issue resolved by the court involved whether prior securities laws ruling actually precluded an agency liability claim against the association. The court found that the law did not impose such a restriction.

The court then examined traditional agency law principles and found the facts on record did not support the inference that KPMG Belgium, U.S. and UK were the agents of KPMG International. The plaintiffs prayed the court to adopt the ruling of the only court that has allowed a Rule 10b-5 claim against a Swiss Verein to proceed based on a theory of vicarious liability.50 KPMG International's counterpart in Cromer was Deloitte Touche Tohmatsu ("DTT"), a Swiss Verein to which Deloitte & Touche (Bermuda) ("DTB") belonged. The judge in Cromer, after concluding that DTB had actual authority to act as DTT's agent, permitted the plaintiff to amend the original pleading to allege that both misleading audit opinions and scienter could be imputed to DTT.

The court in Lernout & Hauspie held that the allegations at issue in Cromer differed substantially from those at issue there. Namely,

In Cromer, the judge did not rely solely on the fact that DTT's representations in its "marketing materials" may have led third parties to believe that an agency relationship existed between them. Rather, the judge inferred that in light of the plaintiff's other allegations, such third-party representations "bore a relationship to the way Deloitte actually conducted its business," i.e., DTB had "actual authority to act as [DTT's] agent." The other factual allegations included the following: the audit proposal stated that DTB was "part of Deloitte Touche Tohmatsu International"; the Offering Memorandum stated that the Fund retained "Deloitte & Touche," not DTB, as its independent auditor; and--most important--all audit reports bore the name and logo of DTT, as well as "Deloitte & Touche" with an accompanying Bermuda address, and were signed "Deloitte & Touche" in cursive signature.

The court held that it had not been presented with any specific allegations -- aside from advertising slogans from the Website and Annual Report to Shareholders -- to support the inference of an agency relationship. The plaintiffs did not allege that any of the audit reports bore the name or logo of KPMG International, or any signature other than that of KPMG Belgium. Nor did they cite wording from an audit proposal or offering memorandum implying that KPMG International itself was retained as an independent auditor. The court held that despite the fact that different KPMG entities cooperated on different aspects of the L & H audits, there was no support for the notion that such collaborations occurred at the behest of, on behalf of, under the direction of, or subject to the control of KPMG International. The court thus concluded that:

[t]aken together, the allegations in the Complaint and inferences that can be fairly drawn from them do not support Plaintiff's assertion that KPMG Belgium, U.S. and UK had actual authority to act as KPMG International's agents. The ... claim against KPMG International is dismissed.

Lernout & Hauspie underscores the fact that associations and their member firms must be aware that a court will likely examine agency principles in deciding whether the association or one of its members is liable for the acts of another member. Special caution should be exercised in any communication with third parties, whether through reports, marketing materials or web sites that would give the appearance that any member firm is acting on behalf of the association. As Lernout & Hauspie demonstrates, the mere sharing of a common name does not in itself give rise to vicarious liability, as long as the separateness of the member firms is made clear in public pronouncements.

---

51 Id. (citing Restatement (Second) of Agency § 1 (1958) (specifying that for an agency relationship to exist, two people must agree that one person shall act on behalf of the other person and subject to his control)).
IV. For-Profit and Non-Profit Approach

Voluntary unincorporated associations have been classified as associations organized for profit or as non-profit associations. The determination of whether an association is considered for-profit or not-for-profit is important because courts have distinguished between both types of associations in determining member liability.

Generally, a non-profit association is defined as an association whose net gains do not inure to the benefit of its members and which makes no distribution to its members, except on dissolution and is formed for benevolent and charitable purposes.

For-profit associations are more difficult to define because the issue of defining “profit” involves whether the association itself seeks to make a profit or whether its business-related activities are intended for the profit of the association’s members. Case law analysis suggests that both circumstances meet the definition of “profit.” One Texas court, after examining their nature and purpose, held that a group of individuals were members of a for-profit unincorporated association. The court reached this conclusion despite the fact that the association itself never made a profit. Instead, the court looked to the pecuniary purpose behind the association as the determinative factor.

Courts have considered members of unincorporated associations, which are organized for-profit, as partners in their relation to third persons. In contrast, most jurisdictions do not consider members of unincorporated associations formed for moral, benevolent, social, patriotic, or political purposes, partners, even though such associations may be conducted partly for pecuniary gain.

There are various membership associations of independent accounting firms operating throughout the world. The members pay membership fees to the organization and, in return, become part of a network of professional accounting firms practicing worldwide. One important tangible benefit derived by the member firms is the referral of business, for which referral fees are derived. It is significantly possible that courts will deem these membership associations to be organized as for-profit, despite the fact that they have expressly categorized themselves as not-for-profit.

Members of a for-profit association are considered by the many courts to be partners in their relation to third persons. Accordingly, they may be held liable for the acts of other members

---

52 See 6 AM. JUR. 2d Associations and Clubs § 2 (1964).
54 Id.
55 Scalon v. Duffield, 103 F.2d 572, 573-74 (6th Cir. 1939).
under partnership law. On the other hand, members of non-profit associations are subject to agency law. The following is a discussion of the legal principles and definitions of key terms that apply to findings of such potential liability.

The clearest definition of potential liability is contained in an old Connecticut Supreme Court decision. The court held that members of a voluntary association formed for the purpose of engaging in business relationships and making profits are liable, as partners, to third persons for contracts entered into within the scope of an association’s activities. In this situation, the court held that a joint judgment against all association members was justified. The court also held that when the purpose of the association is not for business or profit, the liability, if any, of its members arises out of the relation of principal and agent, and only those members who authorize or subsequently ratify an obligation may be liable for the acts of other association members.\(^57\)

A California court has held that vicarious liability of one member of an unincorporated association for unlawful acts of other members may exist if there is personal participation by the person sought to be charged in an unlawful activity, or if that person sets the conduct underlying the claim "in motion."\(^58\)

In addressing the issue of whether the members of an association whose functions are fraternal or social may be held liable for the acts of an individual member, courts have required the plaintiff to produce evidence that the individual members were active participants in the wrongful conduct.\(^59\) Mere membership in an association does not subject the individual members to liability for the negligent conduct of their associates. The members are personally liable for "tortious acts which they individually commit or participate in, or which they authorize, assent to or ratify."\(^60\) The liability of a member of an unincorporated association is based upon "his direct, active negligence, whether it takes the form of an act or a failure to act."

Similarly, the potential liability of an unincorporated Texas association or its members depends upon the court's classification of the association as non-profit or for-profit.\(^61\) In a Texas decision, an injured employee brought a negligence claim against five members of a business association. The court held that the members of the association were affiliated with one another for pecuniary gain. Therefore, they were jointly and severally liable "as partners for injuries

\(^{57}\) See Azzolina v. Order of Sons of Italy, No. 440, 119 Conn. 681, 691, 179 A. 201, 204 (1935).


\(^{60}\) Guyton v. Howard, 525 So. 2d at 956.

\(^{61}\) Cox v. Thee Evergreen Church, 836 S.W.2d 167, 169, 170 (Tex. 1992) (holding that member liability depends upon factors such as the nature of the association); Golden v. Wilder, 4 S.W.2d 140, 142 (Tex. Civ. App. Fort Worth 1928) (holding members of a for-profit association jointly and severally liable under partnership law).
resulting from the negligence of their employees to the same extent as if they had entered into an ordinary partnership agreement."\textsuperscript{62}

In another case, a Texas court held that when an unincorporated association organizes for non-profit purposes, the unauthorized or unratiﬁed representations of a member do not bind the members of a non-profit unincorporated association.\textsuperscript{63} Instead, for member contractual liability to extend, the plaintiff must ﬁrst demonstrate that an authorized member, or the membership as a whole, ratiﬁed the contract.\textsuperscript{64}

The determination of how much ratiﬁcation is enough to make a member liable under a contract or tort is signiﬁcant. In a Texas case, the defendant church sought to erect a new building. A majority of the congregation stood during the Sunday service to signify their agreement to a proposed construction contract. Afterwards, a few church trustees met with a contractor and signed a construction contract and note. The church members allegedly breached the contract and the building was never built. The church trustees argued that there was no contract because there was of no ratiﬁcation by the church. Disagreeing with the trustees, the appeals court held that evidence of the public ground breaking ceremony, the vote by the congregation, and the execution of personal guarantees by the pastor, trustees, and over two-hundred members, were all relevant in establishing the authority of the trustees to contract for the building. Therefore, the evidence could be used to prove the contract's validity. The relatively routine acts of ground breaking ceremonies and the signing of guarantees established the ratiﬁcation of the contract by not only the trustees, but perhaps by the congregation as a whole.\textsuperscript{65} The court added that it was possible to contract against the liability of individual members, seemingly to soften the harsh potential for liability of association members.\textsuperscript{66} The question of ratiﬁcation is a fact question for the jury.\textsuperscript{67}

If member associations are classiﬁed as non-proﬁt, general agency principles will mandate participation requirements, authorization or ratification prior to imposition of association liability. On the other hand, if associations are considered to be for-proﬁt, partnership principles will apply, thus possibly extending joint and several liability amongst members.

\textsuperscript{62} See Golden v. Wilder, 4 S.W.2d 140 (Tex.Civ.App. Forth Worth 1928)
\textsuperscript{64} Id. (holding that non-contracting members of an unincorporated association could not be held personally liable absent a showing of authorization or ratification).
\textsuperscript{66} Id.
\textsuperscript{67} Id. at 159.
V. Control Approach

In a 1906 decision, the United States Supreme Court found that the members of the Virginia Pilot Association, whether technically partners or not, were not liable for torts of member pilots.\(^68\) The Court concluded that:

> when a man is carrying on business in his private interest and entrusts a part of the work to another, the world has agreed to make him answer for that other as if he had done the work himself. But there is always a limitation. It is true that he is not obeyed. But when he could not select, could not control, and could not discharge, the guilty man, he does not answer for his torts.\(^69\)

The Court reasoned that the inability of the members of the Virginia Pilot's Association to discharge its members or to control or direct them in the performance of their duties as pilots made it impossible to hold the individual members of the association vicariously liable for the torts of other members of the association. Additionally, the Court further determined that although the Virginia Pilots Association billed customers for all the work performed by its members and remitted earned fees to its members, this alone was not considered to be “profit sharing.” Indeed, the Court determined that it was simply a “mingling of funds.” Moreover, the fact that the association and its members were “contributing to keep a common office from which bills might be sent out and where a few details of common interest could be attended to” did not convert the nature of the association and its members into a partnership. Thus, the individual members and the association could not be held liable for the negligence of an individual member acting independently.

In 1928, a Texas court held that the primary and controlling consideration as to the liability of an association and its members for acts of the members, was that no member had control over how other members performed in their duties.\(^70\) Moreover, the court found it significant and important that there was no joint management or control by the intra-related members.

The Maryland Court of Appeals held that certain factors as to whether the drivers of taxicabs operated independently or were the agents of the association in determining association liability for a driver’s negligence were questions of fact for the jury.\(^71\) In holding that a fact issue existed as to the association’s potential liability, the Court found the following facts significant: (1) the defendant corporation is an association of independent taxicab owners; (2) the defendant charged its members dues and maintained a central garage and service station, and has a central telephone exchange where its members and its drivers make and receive calls and directions; and (3) the defendant issued a booklet to be used by drivers and owners, containing, among other things,

\(^68\) Guy v. Donald, 203 U.S. 399, 27 S.Ct. 63, 51 L.Ed. 245 (1906).
\(^69\) Id.
\(^70\) Griffdu v. U.S., 25 F.2d 312 (1928).
\(^71\) Association of Independent Taxi Operators, Inc. v. Elizabeth Kern, 178 Md. 252, 13 A.2d 374 (1940).
rules and regulations for the conduct of the business and operations of the cabs, owners, and drivers, and the personal conduct and behavior of drivers of cars. The association also had the ability to discharge and penalize members through the role of the Personnel Manager, which was established by the association. The Court thus determined that most, if not all, these factors were significant in determining the association’s liability.  

VI. Principles of Liability Under International Law

In trying to gain a comprehensive understanding of association liability issues under international law, an examination of the laws of various other countries was pursued.

Article 143 of the Swiss Code of Obligations mandates that without declaration of solidarity intent by the obligors, solidarity develops only when expressly prescribed by law. Solidarity is the equivalent to joint and several liability in the common law system. The sections of the Swiss Civil Code pertaining to associations do not reference joint and several liability of associations and their members. Therefore, because the Code does not expressly prescribe that there might be joint and several liability among the association and its members, the members and the association may be held jointly and severally liable only if they agree so.

In Argentina, another Civil law system country, Article 39 of the Civil Code states that associations are considered entities entirely different from their members and that the members are not liable for the debts of the association unless they expressly agreed to become jointly liable or guarantee the association’s debts. Article 43 states that legal persons, including associations, are liable for the damages caused by their dependents. Similar to the Swiss Code of Obligations, Article 701 states that in order to have solidarity (joint and several liability), it is necessary that the parties express such intent, or that the law prescribe it.

Under English law, an association and its members are potentially liable for the acts of another member under agency principles. Similar to U.S. courts, the main issue in determining potential liability is whether the alleged wrongdoer acted within the scope of his or her “actual, implied or ostensible” authority in binding the association or its other members. Potential liability under this analysis is determined on a case-by-case basis. However, use of agency law principles to bind an association and members suggests that common activity by members may serve to bind the associations if any wrongdoing occurs.

For example, the issue of member liability was raised in England in conjunction with the considerable litigation involving the demise of Bank of Credit & Commerce International (“BCCI”). Claims were brought against BCCI’s former auditors, PriceWaterhouse Coopers

---

72 Id.
73 See Hornsby & others v Clark Kenneth Leventhal (a firm) & others, 4 All ER 567 (2000).
Although the litigation involved potential liability for affiliated members of the PWC organization, published decisions in the case do not address comprehensively the potential liability of PWC members other than those involved in the BCCI engagement.76

VI. Conclusion

The majority of trade associations are unaware that their acts may give rise to liability for an association or its members. Membership associations generally do not share profits, but members may pay dues or participate in exchange of referral fees. Pursuant to the aforementioned legal precedent, these fee arrangements alone would not impose vicarious liability among member firms for the tortious conduct of an individual member. Moreover, vicarious liability is less likely when it does not appear that member firms have the ability to control the practices of other member firms, either directly or indirectly, or to participate in or control member firms’ management.

While some courts in determining whether association member firms could be held vicariously liable for the tortious acts of other members have distinguished between non-profit and for-profit associations, the general rule is that the association’s liability is determined by whether the member is under the control of the association, or whether the member has the right to control his or her acts. A voluntary association is not liable for the tort of a member when perpetrated beyond the scope of the association’s control.77

The current landscape of member association liability is broad and varied. The myriad rules and approaches certainly need to be considered when member associations develop and implement business plans and operational structures. It is not conclusive, however, that mere participation in an association, or the engaging of any one particular conduct will automatically give rise to member association liability.

75 Id.
76 Ultimately, the BCCI litigation involving PWC was settled.