

management matters

Court Rejects Contract Claim Based on Professional Ethics Rules

By Jonathan A. Wexler

A federal court in New York City recently dismissed a claim by a certified public accountant that the termination of his employment constituted a breach of an implied contract to comply with the ethical rules of the accounting profession. By its decision, the Southern District of New York refused to extend to CPAs job protection similar to that which New York state's highest court gave attorneys in 1992.

The Facts

In the case of *Smith v. AVSC International, Inc.*, plaintiff Ed Smith was a CPA employed by AVSC International, Inc. ("AVSC" or the "Company") as its controller from September 1998 through September 2000. AVSC is a New York City-based not-for-profit corporation that provides family planning services. Smith alleged that the Company engaged in improper financial transactions, and advised the Company's vice president of human resources (Jeanne Haws) that he was

considering reporting those transactions to the United States Agency for International Development, an organization for which AVSC performed services.

On Sept. 20, 2000, Smith told Haws that he had informed Arthur Anderson, the Company's external auditor, about accounting misconduct at AVSC. An hour later, the president of the Company discharged Smith for insubordination, and offered him a severance package in exchange for a release and a confidentiality agreement. Smith refused, and commenced a lawsuit against AVSC.

In addition to asserting claims of sex and age discrimination, Smith alleged that he was fired because of his complaints about AVSC's fraudulent financial and business practices. According to Smith, this latter basis for his discharge violated an implied contract between him and the Company to follow the ethical reporting standards of the accounting profession. AVSC made

a motion to dismiss Smith's complaint. In considering such a motion, the court was obligated to assume the truth of Smith's allegations and dismiss the complaint only if Smith could prove no set of facts that would entitle him to relief.

The Court's Decision

The law of New York state (and many other states) is that employment that is not for a fixed term (e.g., six months, one year) is at-will and may be terminated at any time for any reason, except in violation of a statute or in breach of a contract. New York courts have been extremely hesitant to imply terms arising from professional ethical standards in at-will employment relationships. In *Sabetay v. Sterling Drug, Inc.*, one of New York's leading employment-at-will cases, the New York Court of Appeals rejected an accountant's breach of contract claim that was based on Sterling Drug's corporate policies requiring reporting of financial improprieties.

However, in the 1992 case of *Wieder v. Skala*, the New York Court of Appeals held that an attorney who was discharged for insisting upon reporting misconduct by fellow associates could maintain a claim for breach of an implied contract. The *Wieder* court found that the statutory Code of Professional Responsibility, which requires attorneys to report other attorneys' ethical violations and subjects attorneys who fail to do so to disciplinary action, bound both the lawyer and the law firm, and was such an integral part of an attorney's employment relationship that it gave rise to an implied contract between the attorney and the firm for which he worked.

Smith argued that as a CPA licensed by the Commonwealth of Pennsylvania and a member of the American Institute of Certified Public Accountants, he is subject to certain ethical requirements contained in Pennsylvania law that should provide the basis for an implied contract claim. However, Judge Sweet of the Southern District of New York declined to extend the reasoning of *Wieder* to Smith's complaint against AVSC, and cited two prior Southern District cases that dismissed implied contract claims brought by CPAs who were discharged for refusing to engage in or for reporting financial wrongdoing.

Judge Sweet also relied on *Fry v. McCall*, a 1996 Southern District case that rejected an implied contract claim by an individual who worked in the New York State Comptroller's office and was discharged after "voicing concerns about audit reports her office had issued." Although the court found that Fry had been terminated for "exercising her general professional ethical obligations," the judge granted the defendant's motion to dismiss. In so doing, the Fry court held that the "general ethical obligations" on which Fry (who was not apparently a CPA) relied were not comparable to the binding standards codified in the attorneys' Code of Professional Responsibility, and, thus, did not give rise to an implied contract, as in *Wieder*. Accordingly, Judge Sweet dismissed Smith's breach of contract claim.

Conclusion

The court in *Smith v. AVSC* seemed uncomfortable with the result it reached, stating that "it is difficult to draw a rational distinction between attorneys operating under professional codes of conduct that have been codified into law and accountants working under similar conditions." One of the cases on which Judge Sweet relied held that "there is nothing in *Wieder* suggesting that standards articulated solely by private bodies are legally enforceable." Accordingly, the ethical rules promulgated by the AICPA and the New York State Society of CPAs are not likely to give rise to a breach of implied contract claim.

However, it is possible that a court would recognize a contract claim that was based on the New York State Board of Regents' rules governing unprofessional conduct. Moreover, such a claim is more likely to arise in the context of employment at an accounting firm than at a corporation that employs CPAs in its finance or accounting departments. In any event, employers of CPAs must be careful when making personnel decisions in circumstances that may involve the application of rules governing the professional and ethical obligations of their CPAs/employees. ▀

Jonathan A. Wexler, Esq., is an attorney in the New York office of Vedder Price Kaufman & Kamholz, where he practices labor and employment law.

SMALL BUSINESS SEMINAR

DATE Tuesday, October 23, 2001

TIME 8:30 am - 10:30 am

LOCATION NYSSCPA
530 Fifth Avenue
5th Floor, NYC

COMMITTEE CHAIRMAN AND CONFERENCE MODERATOR

Arthur M. Koplowitz, CPA,
of Weinick Sanders Leventhal & Company, LLP

TOPICS INCLUDE

- **Financing Alternatives:**
Marc Albaum, CPA
- **Business Strategies:**
Maurice Berkower, CPA
of Sultanik Krumholz & Berkower LLC, Teaneck, NJ
- **Estate Planning:**
Kevin Berman, CPA
of Israeloff, Trattner & Company CPAs P.C.
- **Business Valuations:**
Robert Meier, CPA of Friedman Alpren & Green LLP

COST: \$10 per person

For further information and reservations:

Arthur Koplowitz
(212) 869-3333
akoplowitz@wlsco.com

new york state society of
NYSSCPA
certified public accountants
530 fifth avenue, new york, ny 10036-5101
www.nysscpa.org