IN THE MATTER OF: PRICEWATERHOUSECOOPERS LLP and DIVISION OF MEDICAL ASSISTANCE AND HEALTH SERVICES	STATE OF NEW JERSEY OFFICE OF ADMINISTRATIVE LAW OAL Docket No. HMAPR 07739-2007N

BRIEF OF AMICI CURIAE NEW JERSEY SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS AND THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS IN SUPPORT OF PRICEWATERHOUSECOOPERS LLP'S MOTION TO DISMISS THE NOTICE OF CLAIM

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PRELIMINARY STATEMENT

The American Institute of Certified Public Accountants (the "AICPA") and the New Jersey Society of Certified Public Accountants (the "NJSCPA") respectfully submit this brief as *amici curiae* in support of PricewaterhouseCoopers LLP's ("PwC") Motion to Dismiss. *Amici* request that the motion to dismiss be granted because permitting the Division of Medical Assistance and Health Services' ("DMAHS") claim against PwC would alter the existing standards of an accountant's liability to third parties, establish deleterious precedent damaging to the clear policy established by the Legislature, and be contrary to the principles of public notice and hearing in administrative rulemaking.

INTEREST OF THE AICPA AND NJSCPA AS *AMICI CURIAE*

The AICPA is the national organization of the certified public accounting profession, all of whose more than 340,000 members are certified public accountants. Among the AICPA's purposes are the promotion and maintenance of high professional standards of practice. In pursuit of these ends, the AICPA has been a principal force in developing accounting and auditing standards, drafting model legislation, sponsoring educational programs, and issuing professional publications to improve the quality of services provided by CPAs. Because of its historical role in formulating standards relating to audits, reviews, compilations, and attest engagements, and the reports issued thereon, the AICPA maintains a strong interest in the scope and bases of civil liability sought to be imposed on accountants pursuant to those standards.

The NJSCPA, founded in 1898, is the only statewide organization for certified public accountants in the State of New Jersey. The mission of the NJSCPA is to promote and maintain high professional and ethical standards of public accountancy in New Jersey; to develop and approve accountant education and research; and to protect the interests of the public and the

members of the NJSCPA. The membership is currently over 14,000 members, which represents approximately 65% of all licensed certified public accountants in New Jersey.

Neither the NJSCPA nor the AICPA has an interest in the particular dispute at issue. However, because of their (1) extensive understanding of the accounting profession and (2) commitment to the public interest, these organizations of CPAs are deeply concerned about the potential decision in this case inasmuch as it threatens to broaden, without any basis, the circumstances under which an accounting firm may be liable to third parties for alleged errors in a Medicaid cost report, and potentially other reports and information submitted to regulatory agencies.

This is of particular concern to certified public accountants because accounting firms have increasingly been targeted as "deep pocket" defendants when public or private claimants seek redress for the errors or alleged misdeeds of their clients. Particularly when other potential defendants prove insolvent, or unable to fully satisfy alleged losses, claimants turn against the accounting firm that may have reviewed the relevant financial information.

In addition to the obvious financial and reputational exposure caused by the mere filing of lawsuits and other claims, increased litigation risk affects the ability of the profession to recruit and retain highly qualified personnel. *See* U.S. Chamber of Commerce, Auditing: A Profession at Risk at 8 (January 2006) ("Qualified auditors face ever-growing incentives to exercise their professional options and may opt to leave the profession altogether."). This, in turn, may further reduce the availability, and therefore increase the cost, of accounting services.

This state's Legislature has already recognized the harm that can befall accountants from unexpected third party claims, as discussed below. It is important that the potential liability of an accounting firm to third parties for alleged misrepresentations in a cost report or similar client

representation be consistent with the Legislature's mandates, and, at a minimum, be governed by a predictable set of standards so that accountants may, among other things, understand their risk in undertaking such engagements.

BACKGROUND

Amici rely upon the background set forth in PwC's Memorandum of Law, dated March 24, 2008 ("PwC Mem."), at pages 4-8.

ARGUMENT

I. THE PROPOSED APPLICATION OF SECTION 7(H) BY THE DMAHS CONSTITUTES AN IMPERMISSIBLE END-RUN AROUND THE ACCOUNTANT LIABILITY ACT.

At issue in this matter are Medicaid "cost reports" prepared by PwC's client. Health care facilities certified by Medicaid must submit an annual cost report to DMAHS to receive reimbursement from Medicaid. The cost reports identify the facility's reimbursable costs, and Medicaid reimbursement is generally calculated based on the previous year's cost report. PwC performed attest engagements relating to these cost reports, which, among other things, relied on a representation taken from the client that "all significant information" that was "relevant" to the cost reports had been provided to PwC. (PwC Mem. at 4.) PwC had no interaction whatsoever with DMAHS in connection with these engagements.

In 1995, New Jersey's Legislature enacted the Accountant Liability Act, N.J.S.A. § 2A:53A-25 ("ALA"), which prohibits third parties from bringing negligence claims against accountants except in narrowly prescribed circumstances. Under the ALA,

> *Notwithstanding the provisions of any other law,* no accountant shall be liable for damages for negligence arising out of and in the course of rendering any professional accounting service unless: ...
>
> (2) The accountant:

> (a) knew at the time of the engagement by the client, or agreed with the client after the time of the engagement, that the professional accounting service rendered to the client would be made available to the claimant, who was specifically identified to the accountant in connection with a specified transaction made by the claimant;
>
> (b) knew that the claimant intended to rely upon the professional accounting service in connection with that specified transaction; and
>
> (c) *directly expressed to the claimant, by words or conduct, the accountant's understanding of the claimant's intended reliance on the professional accounting service* . . . .

N.J.S.A. § 2A:53A-25(b)(2) (emphasis added).

The DMAHS, however, asserts that under Section 7(h) of the New Jersey Medical Assistance and Health Services Act ("NJMAHSA"), N.J.S.A. § 30:4D-7(h), adopted in 1983, well before the ALA, an accountant should nevertheless be liable to the State for Medicaid overpayments made to its client, even though the DMAHS has not pleaded any cause of action that would satisfy the terms of the ALA before this or any other court, and it, in particular, alleges no communication between the accountant and the DMAHS to meet the very clear and specific requirements of the third element under the ALA. (*See* Brief in Opposition to Motion of PricewaterhouseCoopers, LLC for Summary Decision ("Opp. Mem.") at 19.) This interpretation of Section 7(h) is therefore in direct conflict with the ALA and would significantly alter the landscape of accountant liability to third parties.

In enacting the ALA, the Legislature intended to protect accountants from precisely the kind of third party claim the DMAHS attempts to read into Section 7(h). The ALA addresses the threat of overly broad liability stemming from third party claims that can unfairly burden accountants, and provides protection from claims that should properly run against their clients, not accountants themselves, because:

> [A]n accountant is rarely the primary wrongdoer in negligence cases. Instead, the accountant is sued because he failed to detect the fraud of his

> client. In many cases, an accounting firm is sued because it has "deep pockets," in contrast to its client, which may have become insolvent by the time the investors realize they have been defrauded.

Statement attached to S.826 (March 10, 1994), quoted in *E. Dickerson & Son, Inc. v. Ernst & Young, LLP*, 361 N.J. Super. 362, 367 (App. Div. 2003), *aff'd,* 179 N.J. 500 (2004). As the Supreme Court noted in *E. Dickerson*, the ALA was intended to shield accountants from third party suits except in *very narrow circumstances*, namely, only where it is established that the accountant knew that a specifically identified person intended to rely on the accountant's services, and where the accountant actually expressed his understanding of that reliance *directly* to the third party. *E. Dickerson & Son, Inc. v. Ernst & Young, LLP*, 179 N.J. 500 (2004). The Court further noted that the sponsor's statement supporting N.J.S.A. 2A:53A-25 clarified that the bill was intended to "restore the concept of privity to accountant's liability towards third parties." Id. at 504.

The consequences arising from claims brought against accountants by third parties has been a matter of concern nationwide, with the courts and the various state legislatures adopting a variety of approaches to address the problem. *See, e.g.*, Jay M. Feinman, *Liability of Accountants for Negligent Auditing: Doctrine, Policy, and Ideology*, 31 Fla. State Univ. L. Rev. 17, 17-20 (Fall, 2003); *Bily v. Arthur Young & Co.*, 3 Cal. 4th 370, 834 P.2d 745 (Cal. Sup. 1992); *Credit Alliance Corp. v. Arthur Andersen & Co.*, 65 N.Y.2d 536, 483 N.E.2d 110 (N.Y. 1985). The New Jersey Legislature chose to resolve its concerns through a statute that explicitly and intentionally overrode New Jersey case law, which had essentially eliminated any concept of privity, thereby expanding the scope of accountants' liability to third parties. *See E. Dickerson & Son*, 361 N.J. Super. at 367.

The terms of the ALA reflect the Legislature's specific intent to limit third-party accountant liability to circumstances in which the accountant and the third party had a

relationship separate from the relationship between the accountant and its client. Here, the DMAHS does not plead a cause of action that would meet the terms of the ALA.

The DMAHS seeks to ignore the ALA, and turns to Section 7(h) to attempt to hold an accountant "responsible for" Medicaid overpayments. However, the ALA, adopted well after the NJMAHSA, applies to all third-party actions for negligence against accountants, and unambiguously states that it applies "notwithstanding the provisions of any other law."[1] There is no evidence suggesting that Section 7(h) was intended to (or should) be an exception. Thus, with no support other than its novel and unilateral view twenty-five years after the NJMAHSA was passed, the DMAHS seeks to impose liability on an outside accountant for Medicaid overpayments to the accountant's client.

The DMAHS also argues that, because in a conflict between statutes, a specific provision prevails over a more general statute governing the same subject, Section 7(h) of the NJMAHSA should control. (Opp. Mem. at 17-18.) The ALA specifically states, however, that it applies notwithstanding the provisions of any other law. Furthermore, there is nothing in Section 7(h) that makes it "specific" as to accountant liability; it covers the liability of any person or entity that can be construed to be "responsible for" Medicaid overpayments. On the other hand, the later-enacted ALA specifically addresses accountant liability for negligence to third parties, establishing a clear standard applicable to such claims. Thus, under the rule stated by the DMAHS itself, the ALA, which specifically applies a clear standard to a narrow category of liability and persons, should control over the more general terms of Section 7(h), which allow recovery of overpayments from an undefined category of persons.

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[1] The DMAHS asserts that a negligence standard should be applied to PwC for the purposes of opposing PwC's motion to dismiss. (Opp. Mem. at 16.)

The DMAHS's interpretation of Section 7(h) would create an unintended loophole in the ALA's protection against unfounded third party claims, allowing it to access the potentially deeper pockets of accountants when seeking to recover Medicaid overpayments. Were the court to permit this exception, particularly when there is no indication that the Legislature intended it, and no compelling reason is provided for making such an exception, more invalid "exceptions" will inevitably follow. That is, as other agencies discover provisions into which they can potentially shoehorn accountant liability, the ALA will become riddled with exceptions, and accounting professionals may be burdened with utterly unexpected agency claims that the policy underlying the ALA intended to preclude: namely, those that seek recovery for the misdeeds of the accountant's client. These unanticipated claims will only add to the already extraordinary costs of litigation to the accounting profession that the Legislature sought to reduce.

In short, the unauthorized exception to the ALA proposed by the DMAHS could have a profound impact on accounting professionals performing services for clients in New Jersey. The application of Section 7(h) to accountants may subject them to a new category of liability not only related to Medicaid cost reports, but also unanticipated liability resulting from other engagements, for which they had no opportunity to consider their potential exposure, and to price such services accordingly. Any such exception to the ALA should therefore be left to the Legislature, particularly for the additional reasons discussed below.

II. SECTION 7(H) AS APPLIED BY THE DMAHS IS INVALID BECAUSE THE DMAHS DETERMINATION DID NOT COMPLY WITH RULEMAKING PROCEDURES.

As discussed in Point I, the DMAHS's proposed application of Section 7(h) is clearly precluded by the ALA, which does not permit accountants to be held liable for damages for negligence to a third party unless there is effectively privity between the accountant and the third party. Any change to that policy should be left to the Legislature. *See United Water Res., Inc. v.*

N. Jersey Dist. Water Supply Comm., 151 N.J. 497, 499 (N.J. 1997) ("The Court, however, cannot through statutory construction validate a contractual arrangement that confers or expands the governmental powers of public entities not otherwise delegated by the Legislature in accordance with statutory standards governing the exercise of such delegated powers.") On that basis alone, therefore, this court should dismiss the DMAHS's claim, and need not reach the question of the DMAHS's failure to follow rulemaking procedures.

Even if the DMAHS's proposed application of Section 7(h) were not precluded by the ALA, however, it would still be invalid. The language of Section 7(h) does not support the DMAHS's imposition of liability on an outside accountant, and even if Section 7(h) impliedly authorizes the DMAHS to apply Section 7(h) to accountants, such application is invalid because the DMAHS did not follow the rulemaking procedures required by the Administrative Procedure Act. When statutory language is ambiguous, it cannot be read to confer an express grant of power for an agency to make a unilateral determination of standards of conduct. *Dept. of Labor v. Titan Const. Co.*, 102 N.J. 1, 10 (N.J. Sup. 1985). When there is no express authority, agency authority to perform an action can be inferred from the legislative objectives that inspired a statute's enactment. *Id.* If an agency acts in the absence of clear substantive and procedural standards governing its action that are either defined by statute or set forth in rules promulgated pursuant to the rulemaking procedures of the Administrative Procedure Act, then it acts arbitrarily, and its action must be invalidated. *Metromedia, Inc. v. Dir., Div. of Taxation*, 97 N.J. 313, 328 (N.J. 1984).

A. Section 7(h) Does Not Authorize a Cause of Action Against Accountants.

Section 7(h) does not expressly authorize the DMAHS to bring a cause of action against outside accountants for Medicaid overpayments by their clients. The statute allows the Commissioner to:

> take all necessary action to recover any and all payments incorrectly made to or illegally received by a provider from such provider or his estate or from any other person, firm, corporation, partnership or entity responsible for or receiving the benefit or possession of the incorrect or illegal payments or their estates, successors or assigns, and to assess and collect such penalties as are provided for herein.

N.J.S.A. § 30:4D-7(h). Section 7(h) thus authorizes "recovery" of overpayments from providers and any other person "responsible for or receiving the benefit or possession of the incorrect or illegal payments."

There is no support for DMAHS's position that providers' accountants can be held liable under this provision. There is neither case law nor regulations that support the claim, nor does the statute's own terms. First, Medicaid overpayments cannot be "recovered" from providers' outside accountants, which never have had possession or control of them, nor benefited in any way from them. As observed by even the DMAHS, the policy behind the statute is to *recover funds* from recipients, their estate, third parties, and others. "Recovery" of overpayments suggests that the money is to be retrieved from a person with actual or constructive possession of the funds. Presumably the "others" referred to in the statutory language are others who might have come to possess or control the funds. This policy is enforced by allowing the DMAHS to recover the benefits improperly paid from the person or entity in actual or constructive possession of them, not by allowing the DMAHS to obtain what are essentially "strict liability" damages from outside accountants based on an arbitrary standard unauthorized by the statute.

Second, the statute includes no definition of a person "responsible for" the payments. It is consistent with the statute as a whole to define a person "responsible for" as a person with control of the overpayments or the benefits thereof, for instance a trustee, or corporate officer, from whom it can be "recovered."

Moreover, AICPA standards for attestation engagements – such as that entered into by PwC with regard to the cost reports – state that the CPA attests to the representation of the "responsible party," and further, that the CPA should not take on the role of the "responsible party" in an attest engagement. *See* ASB Statement on Standards for Attestation Engagements 10 (January 2001). Under the applicable accounting standards, the accountant is not, nor may be, the "person responsible" for the representations made in the cost report. This is consistent with a reasonable interpretation of who was intended to be covered by "responsible for" under Section 7(h), i.e., those directly involved with the provision of information and receipt of the proceeds.

Finally, the DMAHS offers no reasonable alternative meaning for "responsible for." Rather, the DMAHS attempts a unilateral interpretation, rather than proper rule-making, by first suggesting that accountants are subject to strict liability under 7(h), and now, by grafting a negligence standard onto the statute for the purposes of opposing PwC's motion to dismiss. (Opp. Mem. at 16 ("if the court finds that PwC knew, or should have known, that the cost data was not accurate, the court could find that PwC was responsible for the overpayments").) Nowhere does the statute suggest any standard other than "responsible for," and there is no support for a standard that should encompass negligence, rather than knowing conduct. In short, the statute provides no standard to be applied to outside accountants.[2]

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[2] DMAHS attempts to distinguish cases in which the court found that statutes did not expressly authorize agency action by simply asserting that, although in those cases, the statutes did not expressly authorize the actions taken, here Section 7(h) expressly authorizes it to recover overpayments from those "responsible for" the overpayments. The statutory authority here is no different from those found to be implied, not express, in *Dept. of Labor v. Titan Const. Co.*, 102 N.J. 1, 14 (N.J. Sup. 1985) (authority to debar officers of contractor implied, not express, when statute authorized debarment of the "person responsible" for the contractor's failure to pay the prevailing wage); *Metromedia, Inc. v. Dir., Div. of Taxation*, 97 N.J. 313, 322-24 (N.J. Sup. 1984) (authority to base franchise tax on "audience share" to determine receipts implied when statute authorized the agency to use "other similar or different method" of allocation); *Crema v. N.J.*

Nor is there any support for such a standard in the case law. The sole court that has interpreted the person "responsible for" provision as extending beyond those directly receiving or benefiting from the payments found, in *dicta*, that 50% controlling shareholders of a company might be liable under a theory of vicarious liability if a showing was made that they certified to the DMAHS that the payments or cost reports were correct. *See Sendar v. New Jersey*, 230 N.J. Super. 537, 551-54 (N.J. Super. 1989).[3] No court has extended the vicarious liability theory under 7(h) to an outsider, and there is no basis to extend it here, to an outside accountant who did not receive the Medicaid benefits or make any statement to the DMAHS.

In sum, there is no specific authorization whatsoever for the DMAHS to bring a claim under Section 7(h) against an outside accountant which never received or possessed Medicaid overpayments made to its client, and which never communicated in any way with the DMAHS.

B. The DMAHS's Application of Section 7(h) to Outside Accountants Constitutes Creation of a Rule, and is Invalid Without Notice and Hearing.

As shown, Section 7(h) thus does not provide express authority to the DMAHS to hold an accountant liable for Medicaid overpayments received by its client. Even if it is construed to impliedly authorize such a claim, which *amici* urge is completely contrary to the constraints of the ALA, the DMAHS's application of Section 7(h) to PwC, and by extension to all New Jersey accountants, should be subject to an administrative rulemaking process. The DMAHS should not be permitted to subject accountants to a new category of liability in an *ad hoc* adjudication:

Dept. of Envtl. Prot., 94 N.J. 286 (N.J. Sup. 1983) (authority to issue conditional construction permits did not expressly authorize issuance of conceptual approval of a proposed development).

[3] We have identified two decisions in the Office of Administrative Law that apply Section 7(h) to corporate officers who were also significant shareholders (or married to significant shareholders) in the provider that received Medicaid overpayments. *See DMAHS v. Klein*, 1992 WL 257725 (N.J. Adm. 1992) (controller and vice president married to shareholder in closely held family corporation personally liable for overpayments under Section 7(h)); *Levin v. DMAHS*, 2003 WL 23174467 (N.J. Adm. 2003) (CEO and 30% shareholder personally liable for overpayments under Section 7(h)).

Notice and hearing are required to allow those affected by the new interpretation of Section 7(h) to participate in the process, and require the DMAHS to clarify exactly what standards it seeks to apply to an outside accountant reviewing cost reports.

"[F]airness requires that an administrative agency use its rulemaking power to establish the standards it intends to enforce by adjudication." *Titan Const. Co.*, 102 N.J. at 14. A critical aspect of the definition of a rule is its "general applicability and continuing effect." *Metromedia*, 97 N.J. at 329. "[W]hen the agency action is concerned with 'broad policy issues' that affect a large segment of the regulated, or general public, rule-making as such is implicated," and "it is particularly appropriate that the parties affected by the proposed agency action have the opportunity to participate in the process leading to the agency determination." *Id.* at 330. In addition, "[w]hen an agency's determination alters the *status quo*, persons who are intended to be reached by the finding, and those who will be affected by its future application, should have the opportunity to be heard and to participate in the formulation of the ultimate determination." *Id.* at 330.

Accountant liability to third parties is a broad policy concern that has been specifically considered by the Legislature, and any agency determination that creates an exception to the established third party liability standard is accordingly of significant importance as well. The application of Section 7(h) to accountants is unprecedented, and will have an effect on all accountants that take on Medicaid cost report engagements or any other engagements that may affect Medicaid payments to their clients. "[I]t is the antithesis of legislation to make law from case to case and after the fact." *Boller Beverages, Inc. v. Davis*, 38 N.J. 138, 155 (N.J. Sup. 1962). The DMAHS should not be permitted to create a new source of unexpected liability for all New Jersey accountants through an individual adjudication; those affected should be given

notice and an opportunity to be heard. *See Dept. of Envtl. Prot. v. Stavola*, 103 N.J. 425, 435-36 (N.J. Sup. 1986) (rulemaking required when the statute and regulations were confusing and so general as to not put clubs on notice that the DEP might deem beach cabanas to come within "dwelling units or equivalent," regulation listed specific "dwelling units" not including cabanas, and the prior dealings between the clubs and the DEP gave the clubs "no clue" that the cabanas would be considered "facilities" under the statute the DEP sought to apply: "The clubs planned their reconstruction in good faith reliance on the absence of any previous attempt by DEP to regulate beach club cabanas.").

If the DMAHS is permitted to proceed with its claim against PwC, therefore establishing through adjudication a new rule that accountants may be liable for their clients' errors in Medicaid cost reports, it will set a precedent that may eviscerate the ALA with regard to accountant liability to government agencies. The ALA does not except regulatory agencies from its standard for third-party liability, and the DMAHS should not be permitted to except itself without a rulemaking proceeding in which any reasons as to whether it should or should not be an exception are publicly considered.

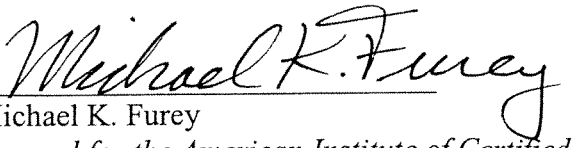
CONCLUSION

This case involves issues of significant interest to the accounting profession. The legal issues presented here may broadly alter the landscape of accountants' liability to third parties in New Jersey, which should only be taken by the Legislature or, under certain circumstances,

through administrative rulemaking procedures. Accordingly, the AICPA and the NJSCPA respectfully submit that PwC's Motion to Dismiss should be granted.

Respectfully submitted,

RIKER DANZIG SCHERER HYLAND & PERRETTI LLP

By: 

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In the Matter of:	STATE OF NEW JERSEY OFFICE OF ADMINISTRATIVE LAW
PRICEWATERHOUSECOOPERS LLP	
	OAL Docket No. HMAPR 07739 2007N
and	
	MOTION FOR ADMISSION
DIVISION OF MEDICAL ASSISTANCE AND HEALTH SERVICES.	*PRO HAC VICE*

I, Michael K. Furey, an attorney in good standing of the State of New Jersey and authorized to practice in this State, hereby move the Office of Administrative Law in accordance with N.J.A.C. 1:1-5.2 to permit the appearance of KELLY M. HNATT, a member of the bar of the State of New York, to appear *pro hac vice*, in the above-captioned matter. An affidavit is attached and is relied upon in support of this motion.

I hereby certify that copies of this motion and the attached affidavit have been served upon all parties in the above-captioned matter.

Dated: June 12, 2008

Michael K. Furey

RIKER DANZIG SCHERER HYLAND &
PERRETTI LLP

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