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Editor's Notes: Implications of POTTER vs DELOITTE

Glenda E. Ried

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A lawsuit filed by Potter & Co., a Lexington, Kentucky firm, against Big 8 accounting firm Deloitte Haskins & Sells (DHS) made headlines as a feature article, "CPA Quarrel," in the Wall Street Journal July 28, 1983. According to the article, Potter & Co. was the largest accounting firm in Lexington. Potter served 1,403 clients, maintained a staff of 31 in their Lexington office, has offices in six other Kentucky cities, and earned annually $3.3 million.

Deloitte, No. 3, had a much smaller one-partner office in Lexington. Suddenly, without prior notice four partners, including the founder of Potter & Co., and twelve employees left Potter for DHS. Deloitte then picked up 961 of Potter's Lexington clients and replaced Potter as No. 1 in town.

The significance of the lawsuit is that it appears to be the first filed by a small accounting firm against a Big 8 firm for anti-competitive practices. Potter's one remaining partner in the Lexington office with partners of the other offices put up financing to hold Potter together and filed suit.

It is common knowledge within the accounting profession, although seldom made public, that if one is taken into a firm on a partnership level that he or she is expected to bring with him or her some valuable clients with significant billings. Usually this person comes from a small local firm and the result may be the end of the smaller firm.

Encroachment

At one time the accounting profession had restrictions on recruiting employees from other firms and on soliciting their clients. In 1978 the AICPA adopted a new rule permitting advertising. A year later, effective March 31, 1979, the AICPA repealed the rule on encroachment which stated a "member shall not endeavor to provide a person or entity with a professional service which is currently provided by another public accountant." The second sentence from Rule 502 on advertising stating "a direct uninvited solicitation of a specific potential client is prohibited" was repealed as well. Thus, it appears there is no violation of the AICPA Code of Ethics and the Kentucky Board of Accountancy implied the same when they dismissed the complaint filed with them by Potter against DHS.

Legal Issues

Certain legal issues remain to be resolved such as contract violations. Potter's partnership agreements stated that partners should give 90 days' notice before withdrawing from the firm. The four departing partners announced their resignation effective immediately. Is this a violation of their contract?

The agreement also contained provisions that departing partners are to compensate the firm for clients taken with them. The implication is there was no such compensation. However, the withdrawing partners have filed countersuit for their capital balances.

Deloitte immediately solicited Potter's clients by sending notices asking them to release their files from Potter. Was this done in a manner misleading and confusing to the clients? Potter says their client lists are proprietary; Deloitte disagrees.

The courts decisions on these and other issues involved will be a determining factor in future moves of this type by other firms.

Ethical Issues

David L. Fister was not only tax partner, but the managing partner at Potter, when he was approached by Frank Kromer of DHS (per WSJ article). Mr. Fister decided to leave and subsequently three other partners found out about it and decided to leave with him. The question is "Does a managing partner have greater ethical obligations to a firm than other partners and employees have because of the position and trust invested in him?" Does he have an ethical responsibility to the employees to provide continuity of the firm and employment for them? Did the employees leave because they believed the firm would fold and they wanted to maintain employment?

Did Mr. Fister consider what the side-effects might be of his leaving Potter for DHS? Did he consider, or care, that the withdrawal of four partners would have a devastating effect upon a firm he helped build? Were there other alternatives? Did these partners gamble, and lose, that the firm, with clients, could be handed over to Deloitte?

It seems to me these are valid ethical questions. I believe that management does have a responsibility toward a firm and its employees. I also believe that business ethics are and must be established by top management and filtered down through organizational levels. Can business ethics be expected at lower levels if not exhibited at the higher levels?

Will local and regional firms continue to vest as much power with their managing partners? Will local and regional firms exercise caution and distrust toward larger firms?

Growth

How and where can an accounting firm find growth? And, "must" a firm continually grow?

Growth for a small firm is usually by having small clients that grow into larger clients. Along with their growing and profitable clients, the small firm adds staff with the expertise to service and keep these clients. Unfortunately, these very clients make them vulnerable to competition and takeover by the larger firms that want their clients.

Until recently the Big 8 firms did not wish to bother with small clients. Now they establish small business departments within their firms. They actively compete for the small profitable client. And they are obtaining growth by acquiring and merging other firms into theirs.

Is the survival of the small firm at stake? Some accountants predict that the small firm will have to specialize to survive, that the small firm will become primarily a write-up and tax service firm, that there will be fewer of them and that many will disappear.

It will be interesting to watch and learn, not only the legal outcome, but also the profession's reaction to the Potter vs. Deloitte case. Ω

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