SCC File No.: 35438

IN THE SUPREME COURT OF CANADA
(ON APPEAL FROM THE COURT OF APPEAL OF QUEBEC)

BETWEEN:

ELLIOT C. WIGHTMAN, et al (see Annex A)

APPLICANTS
(Appellants)

-and –

ESTATE OF PETER N.T. WIDDRINGTON

RESPONDENT
(Respondent)

APPLICATION FOR LEAVE TO APPEAL
VOLUME IV of IV (pp. 1 to 309)
(ELLIOT C. WIGHTMAN, et al, APPLICANTS)
(Pursuant to s. 40 of the *Supreme Court Act* R.S.C. 1985, c. S-26)

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PART I – STATEMENT OF FACTS AND OVERVIEW

A. Overview: Liability of Corporate Auditors to Third Parties – What and Where?

1. At its core, this test case is about corporate governance in Canada. This test case, which has implications for all Canadian corporations, auditors, directors, investors and lenders, asks the following important questions: what are auditors across Canada liable for and where are they liable?

2. With leave, this Honourable Court will have the opportunity to address for the very first time the question of the application of *lex societatis* to auditors – is extra-contractual liability of corporate auditors governed by the law applicable to the corporation defining the requirements? And, what is the legal status of auditors appointed to perform internal corporate functions?

3. This test case also raises the issue of what particular jurisdiction in Canada is the *locus delicti* when a fault committed in one jurisdiction causes harm in another. There is now in Canada manifest confusion as to what the answer is, because the judgment of the Court of Appeal below is:

- inconsistent with this Honourable Court's judgment in *Tolofson*[1]
- also inconsistent with the decisions of other courts in Canada.

4. As Canada increasingly becomes a single large economic unit (and is treated as such by large businesses and large employers), and as Canada concurrently becomes part of a larger more global economy, business people (and their legal counsel) need to know that if/when things go awry, recourse is to a foreseeable, principled court system. The question, though fundamentally a legal one, is fundamental to Canada's economic future as a safe place to do business. Business investors (large and small) avoid risk, and will place their funds where, if something happens, they know what law will apply. Because of the confusion seeded by the Court of Appeal below, there is no clear answer to what one would think would be a simple question.

5. In addition, there is the related issue of directors' liability – or lack thereof. Can corporate directors approve and feed false information to auditors and others regarding the fundamentals of the company's business and financial affairs, ("a sophisticated set-up"[2], the Court of Appeal below called it) and say it was the auditors' fault when they (the directors) get caught.

[1] *Tolofson v. Jensen*, [1994] 3 S.C.R. 1022 ("*Tolofson*") [**Book of Authorities "BOA" Tab 24**].
[2] Judgment of Court of Appeal below, at para. 62 [**Tab 4C**]

B. Castor – New Brunswick Corporation

6. Castor was a private company incorporated under the *New Brunswick Business Corporations Act* (*NB Act*)[3] – heading an international group of companies carrying on business as lenders to developers of real estate (the "Castor Group"). [4]

7. As required by the *NB Act,* Castor's official registered office was established – and always remained so – in New Brunswick. In Canada, Castor also had offices in Calgary, Toronto and Montreal; subsidiaries in Switzerland, Ireland, Cyprus and the Netherlands Antilles; dealings across North America, Europe and Ireland and investors and lenders world-wide.[5]

C. Coopers and Lybrand CA ("C&L") – Auditors

8. C&L, an Ontario partnership of chartered accountants was appointed auditor by Castor's shareholders to perform the annual statutory audits of the financial statements.[6] The audit reports were addressed to Castor's shareholders and entitled "Auditors' Report to Shareholders". As required under the *NB Act* and the engagement agreements, the reports were delivered to Castor's Chair for use at the annual meeting of shareholders.[7]

9. C&L, in their capacity of auditor to Castor, issued share valuation letters to, and for, the directors of Castor pursuant to Castor's Unanimous Shareholders Agreement. C&L, as auditor, also provided to Castor's lawyers certification of certain financial ratios ("Legal-for-Life Certificates") for their use in preparing Legal-for-Life opinions.[8]

D. The Ontario Connection: Ontario Respondent Invests in Castor and Becomes Director

10. In 1989, the Respondent, a successful businessman living in Ontario, invested in Castor to become a director and again in 1991 in response to a "cash call" to face a liquidity crisis in light of lender withdrawals.[9]

11. For his 1989 proposed investment, the Respondent received in Ontario, as part of Castor's informational packages, the C&L audit report for the 1988 financial statements and the

[3] *New Brunswick Business Corporations Act*, C. B-9.1, art. 17
[4] Judgment of Court of Appeal below, at para. 29 [**Tab 4C**]
[5] Trial Judgment below, at paras. 6-8, 40-41, 45 [**Tab 4A**]
[6] Judgment of Court of Appeal below, at para. 29 [**Tab 4C**].
[7] Section 100 of *NB Act* requires directors to place before the shareholders at every annual meeting comparative financial statements that must be prepared in accordance with GAAP principles.
[8] Judgment of Court of Appeal below, at para. 29 [**Tab 4C**]
[9] Trial Judgment below, at para. 14 [**Tab 4A**]

October 1989 Share Valuation letter. After he became a director of Castor, he received, in Ontario, the C&L reports as part of the material sent to the directors.

12. None of C&L's reports were prepared or issued for the Respondent personally, nor for any specific investor or creditor or transaction. C&L had no dealings or understanding with the Respondent for his investments or decisions as a director.

E. The Quebec Connection

13. The C&L audits were performed partly in Montreal, partly in other jurisdictions. The audit reports were coordinated by a single C&L partner (the defendant Wightman), working in the Montreal office, and were finalized in Montreal. They were also delivered to Castor's Montreal office.[10] As for the share valuation letters and the Legal for Life Certificates, they were issued in Montreal by C&L and delivered to Castor, or to Castor's lawyers, in Montreal.

F. Castor Collapses, Trustee Sues the Directors, Burgeoning Lawsuits Against C&L

14. In 1991, the Canadian real estate market collapsed and, in 1992, Castor declared bankruptcy. Castor's Trustee sued Castor's directors, including the Respondent, for illegally declaring dividends in 1991 and for breach of duty for failing to adequately monitor Castor's business[11].

15. The Respondent and other investors, and creditors, along with Castor's Trustee, brought almost 100 separate suits for over $1 billion against C&L. The plaintiffs alleged they relied on C&L reports and opinions in their decision to invest in, or extend credit to, Castor.

16. The Respondent's suit was chosen as a test case for the common issues (negligence and applicable law). All of the other Castor related cases were suspended pending its outcome.[12] When his file was chosen as the test case on the common issues, the Respondent settled the actions undertaken against him *qua* director by the Trustee. He then turned around and amended his declaration to claim from the Applicants the amount of the "settlement".

G. Trial Judgment

17. After characterizing this as "the longest running judicial saga in the legal history of Quebec and Canada", the trial judge ruled:

[10] Trial Judgment below, at paras. 12-13 [**Tab 4A**]
[11] Trial Judgment below, at paras. 30, 50, 3568, 3570 [**Tab 4A**]
[12] Trial Judgment below, at para. 32 [**Tab 4A**]

- Castor's financial statements were materially misstated and misleading; C&L's review did not comply with auditing standards and C&L issued faulty opinons;
- **QUEBEC** law applied; there were no restrictions on auditors' liability for incidental use of their opinions by and with anyone for any purpose or transaction as long as such use was foreseeable;
- the Respondent suffered damages for which he should be indemnified, including the amounts paid to settle with the Trustee;
- the Respondent committed no fault in the exercise of his duties as a director, and it was reasonable for the Respondent to rely on C&L's representations;
- the Applicants, jointly and severally, were to pay the Respondent $2,672,960, interest, an additional indemnity, and the full costs for the trial (still undetermined but claimed in the amount of $27 million); no allocation of the costs on the common issues on a pro rata basis.[13]

H. Court of Appeal Judgment

18. The Court of Appeal granted the appeal in part. It ruled, *lex societatis* did not govern, as the issue of C&L liability was not a question of corporate status. Applying the *lex delicti* rule, the Court concluded the relevant connecting factor was the place of fault and not the place where the prejudice was suffered – C&L fault to be situated in Quebec as this is where the reports and opinions were finalized and issued.[14]

19. Applying Quebec law, the Court of Appeal, after having noted that its own case law on the issue was ambiguous and contradictory, ruled auditors in Quebec (as opposed to the rest of the country) are subject to liability to any foreseeable user of their work.[15] The Court noted that policy concerns for the risk of indeterminate liability (as determined in *Hercules)* had no place in Quebec law.

20. The Court, relying on the concept of "outside director" and applying a less stringent (subjective) standard for diligence and awareness based on this characteristic, opined that the Respondent could not be faulted for his own recklessness in relying on C&L's opinions in his capacity of director.[16] As a result, the Respondent could claim full indemnity from the auditors with respect to the amounts paid to the Trustee to settle its actions against him as director.

[13] Trial Judgment below, at paras. 1, 4, 37, 751-752, 3340, 3343, 3534, 3571-3575 [**Tab 4A**]
[14] Judgment of Court of Appeal below, at paras. 149, 156, 191, 195 [**Tab 4C**]
[15] Judgment of Court of Appeal below, at paras. 202, 212, 235-253[**Tab 4C**]
[16] Judgment of Court of Appeal below, at paras. 397, 400, 402, 410 [**Tab 4C**]

PART II – STATEMENT OF ISSUES

21. This Application for Leave to Appeal raises the following issues:

Issue 1: **Conflicts of Law – Auditor Liability to a Foreign (Non-Client) Third Party?**

Lex Delicti or *Lex Societatis* – Private Wrong or Company Law?

Is the delictual liability of a corporation's auditor for a faulty performance of his/her duties as auditor governed by:

- the *lex delicti* rule or
- the company law that creates and defines his/her office, capacity and duties?

Should the delictual liability of a corporation's auditor be governed by the same law that is applicable to the corporation? Does subjecting the directors and auditors to different laws in relation to financial statements and reporting lead to inextricable difficulties and conflicting results – including conflicting results across Canada?

What Does the Lex Delicti Rule Now Mean?

Which jurisdiction's law should be applied to delict claims when harmful material is prepared in one jurisdiction but is received, relied on and causes harm in another jurisdiction?

Issue 2: **Should there be Two Standards or Indeterminate Liability for Auditors in Canada?**

Should an auditor who issues an opinion be liable to anyone who happens to rely on it under either Canadian common law or Quebec civil law, irrespective of whether that person was an intended recipient or whether that person used it for a different purpose than that for which it was prepared? Is or should the result be materially different in Quebec?

Issue 3: **Can Corporate Directors Avoid the Consequences of their own Negligence and Illegal Acts?**

Should corporate directors bear the consequences of their own faults or can they now shift liability for breaches of their own fundamental duties of diligence?

To what extent does the characterization of "outside" director impact a corporate director's standard of due diligence?

PART III – STATEMENT OF ARGUMENT

Issue 1: **Conflicts of Law – Auditor Liability to a Foreign (Non-Client)**

A. Corporate Jurisdictional/Liability Quagmire

22. This case raises a fundamental corporate conflict of law question: how to determine what law governs auditor liability to a foreign (non-client) third party? When a claim of auditor negligence is made, is the law associated with the auditor's **office** (the law which defines his/her office, appointment, tasks and report) to be applied to determine liability? If the law associated with the auditor's office is not to be applied, then **which** law is to be used, **the law of the place where the deficient work was performed and report issued** or the **law of the investment and loss**? How are courts to determine where a multi-jurisdictional delict occurred or which law is most associated with (should govern) the investor's claim?

B. Multiple Actors, Multiple Jurisdictions

23. At issue in this case is:

> A claim by an **ONTARIO** businessman (Respondent) for [economic] losses suffered as a result of investments in and participation as director of a **NEW BRUNSWICK** company (Castor).

> The investment and losses occurred – in **ONTARIO** – as a result of the Respondent's receipt and reliance – in **ONTARIO** – on audit reports provided by an **ONTARIO** partnership of CA's (C&L) as auditors of a **NEW BRUNSWICK** company (Castor).

> The faults in the audit arise from noncompliance with **NEW BRUNSWICK** statutory requirements which provide for the auditor's office, appointment, capacity, standards, report and duties.

C. Courts Below Apply *Lex Delicti* and QUEBEC Law

24. Both courts below concluded **QUEBEC** law is to be applied to assess liability for damages sustained by the Respondent (both as an **ONTARIO** investor and as a **NEW BRUNSWICK** director) and generally by any reader of the reports, anywhere, for any purpose, in any context. Application of **QUEBEC** law rested on the following analysis:

> Liability of corporate auditors is not a matter governed by the law applicable to the corporation (non-application of *lex societatis* rule, in this case non-application of **NEW BRUNSWICK** law).

The audit (multi-jurisdictional audit of multi-jurisdictional group of companies) was finalized and delivered by C&L's **QUEBEC** office to the client's **QUEBEC** office (considered to be the place of fault).

When the place of the fault (**QUEBEC**) and the place of the prejudice (**ONTARIO** where the Respondent resided and suffered his loss) do not coincide, the delict is to be situated at the place of the fault (in this case, **QUEBEC**).

D. Problematic Analysis and Negative Consequences

25. The analysis of the courts below is **problematic** because:

- The location of the finalization and delivery of the auditor's reports to its client are not relevant factors to the Respondent's allegations.
- The location of the finalization and delivery of the auditor's reports to its client are not relevant factors to the auditor's tasks, responsibilities or standards or to the Respondent as director or investor.
- The location of the finalization and delivery of the auditor's reports to its client could occur in **ONTARIO**, **NEW BRUNSWICK** OR ANYWHERE ELSE.
- The only real attachments to the Respondent are **ONTARIO** (reliance and losses) and **NEW BRUNSWICK** (law governing his shares, shareholdings and office as director).
- The auditors were appointed as corporate officers of a **NEW BRUNSWICK** corporation; their obligations and any deficiencies in the performance of those obligations were defined and delineated by **NEW BRUNSWICK** legislation.
- Emphasis on where an auditor, for internal business reasons unrelated to the legal requirement of the task or its use, chooses to do part of the work renders the applicable law manipulable and fortuitous.
- Even if the relevant connecting factor is the situs of the fault and not the prejudice, this Honourable Court in *Air Canada v. McDonnell Douglas Corp.*[17] established that the locus of the fault, when a defendant fails to warn a plaintiff of a potential danger, is the place where "the warning ought to have been received"; it is not, as the Court of Appeal below concluded, where the incomplete or misleading information is prepared and issued. [18]

26. The criteria selected by the courts below to determine which law to apply to determine liability has serious consequences. By way of example:

[17] [1989] 1 S.C.R. 1554, at p. 1569 **[BOA Tab 2]**

[18] As in *Air Canada*, courts, in addressing the transmission of incomplete, misleading or harmful information, have concluded the place of the fault is where the plaintiff receives and acts upon the erroneous information, not where the erroneous information is prepared or issued. See *Yufe v. Tapping*, [1986] R.J.Q. 1245 (C.S.), at p. 1248 **[BOA Tab 25]**; *Royal Bank of Canada v. Capital Factors Inc.*, J.E. 2004-1644 (C.S.), at p. 7 **[BOA Tab 20]**; *Canadian Commercial Bank v. Carpenter* (1989), 62 D.L.R. (4th), 734 (B.C.C.A.), at p. 741 **[BOA Tab 7]**; *B.C. v. Imperial Tobacco Canada Ltd.*, 2006 BCCA 398, at paras. 62, 67-68 **[BOA Tab 3]**.

- Auditors and companies desiring service at affordable rates can arrange for final reviews and delivery of reports to be in jurisdictions that provide protection against indeterminate liability and litigation, and can remove audit services from jurisdictions that don't.
- The laws and regulations of the province where investor solicitations and investments are made, or those governing the rights and obligations attaching to the shares invested in or the directorship undertaken, become irrelevant.
- Because the standards for internal corporate performance become the physical location where part of the work is done, the possibility of conflicting standards is created. If, for example, C&L chose to do its final review and deliver its report at one of Castor's Board meetings that travelled around the foreign financial capitals of the world or at one of its overseas offices, the applicable law governing liability would be modified.

E. Private Wrong or Company Law?

27. This case raises the following questions of corporate governance and private international law for which there is no case law in Canada – what law applies to the delictual (tortious) liability of a corporation's director or officer who commits a fault in the exercise of his or her corporate duties? Is it the law that creates the corporate office and defines its duties (i.e. the law of the corporation, the *lex societatis*) or the law where the delict occurs, the *lex delicti*?[19]

28. Two approaches to these questions have been proposed:

Solution 1[20]: *lex societatis* applies to the delictual liability of corporate directors or officers as liability is linked to corporate powers and functions.

Solution 2[21]: when liability results from the violation of a provision of the law governing the company, *lex societatis* applies; whereas *lex delicti* applies when director or officer liability is unrelated to a violation of corporate law.

29. The approach of the courts below that *lex societatis* has no role to play in assessing the liability of directors or officers in the exercise of their duties ignores both solutions.

30. In light of the fact that:

[19] As stated in Loussouarn, Y. and M. Trochu, "Conflits de loi en matière de sociétés", *Juris-Classeur de droit international. Fasc.* 194-20, 1997, par. 220 [**BOA Tab 30**] : « Le développement du commerce international, le rôle joué en ce domaine par les sociétés permettent de mesurer l'importance que revêt le problème de la détermination de la loi applicable à la responsabilité civile des organes sociaux. »

[20] See Cohen, D., « La responsabilité civile des dirigeants sociaux en droit international privé », 2003 Revue critique de droit international privé ("RCDIP") 585, p. 597 [**BOA Tab 28**]; M. Brasseur and J. Vermeylen, "Cross-Border Mergers and Reorganizations outside the Cross-Border Merger Directive" in *European Cross-Border Mergers and Reorganizations*, Oxford, 2012, par. 2.12 [**BOA Tab 26**]; Talpis, J. & Castel, J.G., "Interprétation des règles du droit international privé" in *La Réforme du Code Civil*, Tome III, 1993, P.U.L, at p. 838 [**BOA Tab 33**]

[21] Loussouarn, Y. and M. Trochu, *supra*, par. 230 [**BOA Tab 30**].

- an auditor is an integral part of a corporation's structure – he or she is designated as holding an office in Canadian corporate statutes and is appointed by one constituency of the company (shareholders) to carry out internal corporate responsibilities important to corporate governance[22];
- the audit is one of the cornerstones of corporate governance;
- decisions have held that the auditor has an "official" or "institutional" role to play within the structure of the corporation with the consequence that he or she is an officer of the corporation;[23] and
- leading private international law authors favour the application of *lex societatis*[24],

guidance is required by this Honourable Court.

(A) New Brunswick Auditors as Officers under NB Act

31. The *New Brunswick Business Corporations Act* contains numerous provisions which confirm the status of auditors as corporate officers:

s. 105: Shareholders can elect to appoint a person to the office of the auditor.

s. 100: The auditor certifies that the financial statements presented by the directors at the shareholders' annual meeting are in accordance with generally accepted accounting principles.

s. 110: The auditor must make the examinations that are necessary to make the report to shareholders.

s. 111: The directors, officers or employees of the corporation must give the auditor access to the books and records of the corporation and must provide the auditor required information or explanations.

s. 112: The auditor is granted qualified privilege (thus negating the CA argument that the *NB Act* does not contain provisions addressing the delictual liability of auditors).

ss. 105- 108: Numerous references the "office of the auditor".

(B) Certainty, Simplicity, Predictability & Pan-Canadian Audits

32. In Canada, Generally Accepted Auditing Standards (GAAS) and Generally Accepted Accounting Principles (GAAP) are the same throughout the country. Because of their pan-Canadian application, it is possible, for example, to have Quebec accountants audit financial statements of a New Brunswick corporation. Any accountant anywhere in Canada can perform

[22] *Hercules Management Ltd. v. Ernst & Young*, [1997] 2 S.C.R. 165, at p. 204 [**BOA Tab 11**]
[23] See for example: *Mutual Reinsurance Co. Ltd. v. Peat Marwick Mitchell & Co.*, [1997] 1 Lloyd's L.R. 253 (C.A.), at p. 3 [**BOA Tab 15**]
[24] See for example : Cohen, D., « La responsabilité civile des dirigeants sociaux en droit international privé », 2003 Revue critique de droit international privé ("RCDIP") 585, at pp. 598-99 [**BOA Tab 28**].

the audit review of any Canadian company anywhere it chooses. In addition, corporate legislation authorizes companies to keep accounting books in other provinces (or even elsewhere) and to have offices throughout Canada. As a result, the place where any part of an audit will be performed is dependent on choice, is unpredictable and is unlikely to be known by outsiders. By contrast, if the law applied is the law governing the audited company, the applicable law is easily determinable by all interested parties.

33. The application of *lex societatis* to the liability of corporate officers brings certainty and predictability – it does so because it applies irrespective of where the directors or officers happen to perform their corporate functions. This factor is particularly relevant in today's global economy. In this case, for example, Castor was doing business in many North American and European jurisdictions and the directors, managing officers and the auditor performed their duties in various jurisdictions.

34. Application of *lex societatis* to auditor liability ensures the same law is applied to the corporate officers who have financial and statutory functions/duties to perform – the auditors, officers and the directors. Is it logical that the law that creates the office and defines the powers of corporate officers should also govern the consequences that flow from fault in the performance of those corporate duties?

35. As a result of the decision of the Court of Appeal below, the damages of an **ONTARIO** resident suing an **ONTARIO** accounting partnership for work done for a **NEW BRUNSWICK** incorporated company is determined according to **QUEBEC** law, rules and principles. With leave, this Honourable Court can address whether *lex societatis* is better suited to address audit or performance claims within a pan-Canadian and international context.

F. What About *Tolofson*?

(A) Inconsistent Jurisprudence – Disparity within Canada

36. The Court of Appeal in this case concluded where a fault committed in one jurisdiction causes harm in another, the *lex delicti* leads to the application of the law where the fault is committed, rather than where the prejudice (consequences) occurs. This is inconsistent with:

- *Tolofson*;
- jurisprudence from other provinces applying *Tolofson*; and
- international trends and approaches.

37. In *Tolofson*, this Honourable Court established *lex delicti* as the rule of conflict for delictual liability in Canada. While the *situs* of the delict was not in issue in *Tolofson,* the Court recognized that there are situations, notably where an act occurs in one place, but the consequences are directly felt elsewhere, when the issue of where the tort takes place itself raises thorny issues. In such a case, as the Court indicated, it may well be "that the consequences would be held to constitute the wrong."[25]

38. This stems from the fact that a faulty act, in itself, does not give rise to a wrong: a delict only occurs when (and so where) the fault causes injury. As stated in *Moran:*

> . . . I have great difficulty in believing that a careless act of manufacture is anything more than a careless act of manufacture. A plaintiff does not sue because somebody has manufactured something carelessly. He sues because he has been hurt. The duty owed is a duty not to injure.[26]

39. It is the injury, rather than the fault, that is the predominating element of civil liability.[27]

40. Despite *Tolofson,* the Court of Appeal below concluded, when a fault committed in one jurisdiction causes harm in another jurisdiction, the delict is to be situated where the fault is committed. To arrive at this conclusion, the Court misinterprets *Tolofson* and the notion of wrong and wrongful activity which it confuses with the fault[28]. As a result, the Court fails to take into account the fact that the wrongful activity or wrong, for the purposes of *lex delicti,* is not a fault in itself but rather a fault that causes a prejudice. Therefore, where an act committed in one jurisdiction causes a prejudice in another jurisdiction, the wrongful activity is to be situated at the place where the prejudice itself occurs.[29]

41. In *Leonard v. Houle*, the Ontario Court of Appeal, also relying on *Tolofson,* stated that the wrong arises where the injury occurs:

> It seems clear to me that the wrong occurred in the province of Quebec because the injury occurred there. . . . The activity which took place in the province of Ontario, even if found to constitute a breach of duty on the part of the Ottawa police, does not mount to an actionable wrong. The place where the "activity took place" which gives rise to the action is in the province of Quebec".[30]

[25] *Tolofson v. Jensen, supra*, at p. 1050 **[BOA Tab 24]**.
[26] *Moran v. Pyle National (Canada) Ltd.*, [1975] 1 S.C.R. 393, at p. 404 ("*Moran*") **[BOA Tab 14]**
[27] *Moran, supra*, at p. 409 **[BOA Tab 14]**
[28] Judgment of Court of Appeal below, at para. 169 **[Tab 4C]**
[29] See *A. Côté et Frères Ltée v. Laboratoires Sagi inc.*, [1984] C.S. 255, at p. 259 **[BOA Tab 1]**
[30] *Leonard v. Houle*, (1997) 154 D.L.R. (4th) 640, at para. 20 **[BOA Tab 13]**

Thus, in a situation of a cross-border delict or tort, it is where the injury (and not the fault) occurs, that is material.

42. The approach and interpretation of the Court of Appeal below contradicts *Tolofson* and the manner in which wrongful activity and consequences have been interpreted by other courts in Canada, thus creating confusion, contradiction, and confoundment.[31]

43. The Court of Appeal below relied on this Honourable Court's recent decision in *Écosociété* [32] to confirm its interpretation of wrongful activity as meaning the place of the fault rather than the place of the prejudice. It did this despite the fact that, this Court, while addressing the issue of *forum non conveniens,* concluded that the law of Ontario applied to defamatory statements contained in a book entirely written and printed in Quebec.[33] In that case, the fault was committed in Quebec, but the wrong occurred in Ontario where the book was distributed and sold. It would seem that *Écosociété* confirms the view held by the Ontario Court of Appeal in *Leonard* that the wrongful activity occurs at the place where the injury, not the fault, occurred.

(B) Incompatibility with Precedent, Policy and Principles

44. The judgments of the courts below:

- Are incompatible with the reparation (rather than punitive) role of contemporary delictual liability; making it more logical to apply the law where the legal interests of the victim have been interfered with.[34]
- Ignore the fact that application of the law of the plaintiff rather than the law of the defendant generally ensures the victim succeeds or fails according to his/her own law rather than according to the law of the wrongdoer.[35]
- Discount the fact that application of the law of the act leads to inextricable difficulties in the case of contributory faults committed in various jurisdictions.[36]
- Are inconsistent with the legislative provisions recently adopted in the U.K. and Europe – provisions which favor the law of the prejudice.[37]

[31] See for example, *Ostroki v. Global Upholstery*, (1995) O.J. no. 4211 (Ont. S.C.) [**BOA Tab 16**]; *Ross v. Motor Co. of Canada*, (1997) N.W.T. no. 30 (N.W.T.S.C.) [**BOA Tab 19**]; *Barclay's Bank PCL v. Inc. Incorporated*, (1999) ABQB 110, at para. 42 [**BOA Tab 5**]; *Shane v. JCB Belgium N.V.* (2003) O.J. 4497 (Ont. S.C.) [**BOA Tab 23**]

[32] *Éditions Écosociété Inc. v. Banro Corp*, [2012] 1 S.C.R. 636 [**BOA Tab 9**]

[33] *Ibid.*, at paras. 7, 62 [**BOA Tab 9**]

[34] Weill, A., « Un cas épineux de compétence législative en matière de responsabilité délictuelle: la dissociation de l'acte générateur de responsabilité et du lieu du préjudice », *Mélanges offerts à J. Maury*, Tome I, Paris, Dalloz, 1990, pp. 545, 552 [**BOA Tab 35**].

[35] *Ostroki v. Global Upholstery, supra.* [**BOA Tab 16**]

[36] Mayer, P. & Heuzé, H., *Droit international privé*, 8th ed, Paris, 2004, at p. 505 [**BOA Tab 32**].

- Are incompatible with Article 3126 of the *Civil Code of Quebec* (when a fault committed in one jurisdiction causes a prejudice in another, the delict is governed by the law of where the prejudice occurs where it was foreseeable that the prejudice could occur there).
- Conflict with American jurisprudence – in *Harco National Insurance Company*, the Appeal Court, in applying *lex delicti* rejected the "place of the audit" test.[38]
- Are incompatible with the spirit, considerations and reasoning of this Honourable Court in *Moran, Tolofson, Écosociété*, and *Air Canada*, as well as the application of those cases by other courts in Canada and the opinion of leading authors.[39]
- Are discordant with international business and professionals' need for predictability and certainty in a global, electronic marketplace.

45. As the Court of Appeal below purports to apply *Tolofson*, guidance regarding the implications of that decision is required for Canada – which jurisdiction's law should be applied to delict claims when harmful material is prepared in one jurisdiction but is received, relied on and causes harm in another jurisdiction?

Issue 2: Should there be Two Standards or Indeterminate Liability for Auditors in Canada?

A. SCC Says No to Indeterminate Liability

46. In *Hercules*, this Honourable Court addressed the scope of the duty of care which accountants owe to third parties who rely on their opinions to invest in, or extend credit to, an audited company. The Supreme Court of Canada has concluded that, as many people will rely on audited financial statements in their day-to-day dealings with an audited company, an auditor, in principle, does not owe a duty of care to everyone and, in particular, to investors or creditors: "in the general run of auditors' cases, concern over indeterminate liability will serve to negate a *prima facie* duty of care".[40] The mere fact that auditors might know that their financial reports will be used by investors is not sufficient to establish the relationship or purpose connection

[37] *Private International Law (Miscellaneous Provisions) Act,* 1995 U.K. c. 42, s. 11; *Regulation of the European Parliament and Council on the law applicable to Non-Contractual Obligations* (EC no. 864/2007), Art. 4

[38] *Harco National Insurance Company v. Grant Thornton LLP,* (NCCA) 2010, at p.6 **[BOA Tab 10]**

[39] J.G. Castel, *Droit international privé québécois*, Toronto, 1980, at p. 467 **[BOA Tab 27]**; P-A. Crépeau, "De la responsabilité civile extra-contractuelle en droit international privé québécois", (1961) 39 Can. B. Rev. 3, at p. 16 **[BOA Tab 29]** ; J. Walker, *Canadian Conflicts Laws*, 6th ed., vol. 2, at pp. 35-18 **[BOA Tab 34]**

[40] *Supra*, at para. 36. As set out by the Court, while imposing a broad duty of care on auditors could act as an incentive to produce accurate reports, such an approach would bring indeterminate liability and a host of undesirable effects on the cost and supply of accounting services (paras. 33-34). As explained by the Court, limiting the ambit of the auditor's duty of care avoids both indeterminate liability and indeterminate litigation (para. 35) **[BOA Tab 11]**

between a third party and an auditor.[41]

47. As set out in *Hercules*, it is **only** in **exceptional** circumstances that an auditor may be found to owe a duty of care to a **third party** investor or creditor. This involves two conditions. First, when issuing the statement, the auditor must have known the identity of the plaintiff (or the limited class of potential plaintiffs) that would be relying on the statement. Second, the statement must have been used by the plaintiff for the specific purpose or transaction for which it was prepared. If either of these conditions is not present, the concern over indeterminate liability negates any *prima facie* duty of care of the auditor and the auditor will not be liable.[42]

48. In this case, when C&L prepared and issued the audit reports on the financial statements, the Valuation Letters and the Legal-for-Life Certificates, it was not informed of who Castor would approach to invest or obtain credit from or for what amounts. The facts in this case therefore mirror the typical situation – an auditor's opinion is used by a company for panoply of incidental corporate purposes. [43]

B. Quebec Court Says Yes to Indeterminate Liability and No to Harmonization

(A) Ambiguous and Contradictory Approaches in Quebec

49. The Court of Appeal below began its judgment by recognizing its own decisions regarding the extra contractual liability of professionals towards third parties are ambiguous and contradictory.[44] The Court acknowledged **two trends** toward professional liability to non-clients, the **broad** view and a more **restrictive** approach:

> Two trends seem to be taking shape, the first that the extra contractual liability of accountants toward third parties can be incurred regardless of the initial use of the document prepared or the opinion given, the second that that liability can be incurred only if the accountant knows the role or use of its documents or opinions and the people that may make use of them.[45]

(B) Broad View Adopted

50. The Court decided to adopt the broad view and to reject the more restrictive approach which is more in harmony with the concerns and limits articulated in *Hercules*:

[41] *Ibid.*, at paras. 49, 56 **[BOA Tab 11]**. See also *Caparo Industries v. Dickman*, (1990) 2 A.C. 605 (H.L) **[BOA Tab 8]**.
[42] *Ibid.*, at para. 37 **[BOA Tab 11]**.
[43] *Hercules, supra,* at para. 33 **[BOA Tab 11]**; *Rangen Inc. v. Deloitte & Touche*, (1994) Can LII 1555 (BCCA), at para. 39 **[BOA Tab 18]**
[44] Judgment of Court of Appeal below, at para. 202 **[Tab 4C]**
[45] Judgment of Court of Appeal below, at para. 212 **[Tab 4C]**

> ...it would be inappropriate to incorporate into Québec civil law of extra contractual liability general considerations aimed at limiting or restricting the liability of auditors that do not fit in with the general rule laid down in article 1457 (and, before January 1, 1994, article 1053 C.C.L.C.).
>
> Once auditors have a duty, independent of the contract binding them to their client, to act diligently and reasonably toward a third party, it is appropriate to analyze all the specific circumstances of the case in order to determine whether, in light of the general principles of extra contractual civil liability, the conduct of the auditors is faulty and if the fault is a direct, certain and immediate result of the prejudice sustained by the third party, without it being necessary for the claimant to prove that the auditors knew that their opinion was intended for it (or the category of persons of which the third party is a part) and that it was used for purposes for which it was designed (unless the document clearly stated, without ambiguity, the purpose for which it was prepared, which is not the case here).[46]

51. As a result, under Quebec law, auditors are liable to all readers of audited financial statements as auditors know or should know that the financial statements will be used by a variety of people for wide ranging purposes. Any professional is delictually liable to any potential reader – even though the opinion was not intended to be used by that reader, nor addressed to that reader – for virtually any purpose or transaction, anywhere at any time – even though the intended purpose and use is limited by law or contract.

52. The Court of Appeal judgment not only expressly rejects and contradicts the approach, concerns and policies enunciated in *Hercules* (the facts in *Hercules* are strikingly similar to the facts of this case), but it also rejects its own decisions which had sought to restrict extra-contractual duty under Quebec law to known beneficiaries at the time of the work.[47] In *Savard*, for example, the Quebec Court of Appeal ruled that a professional who renders an opinion to a client for a specific purpose should not be held liable to a third party who was not the intended recipient of such opinion or who relied on it for a purpose different than that for which it was prepared, as to decide otherwise could lead to indeterminate liability.[48]

[46] Judgment of Court of Appeal below, at paras. 247-248 [**Tab 4C**]

[47] The restrictive approach is consonant with the principles enunciated by this Court in *Houle v. Canadian National Bank*, [1990] 3 S.C.R. 122 [**BOA Tab 12**] and *Bank of Montreal v. Bail Ltée*, [1992] 2 S.C.R. 554 [**BOA Tab 4**] which address the extent of extra-contractual liability resulting from non-performance of contract. In both cases, this Honourable Court recognized that the mere fact that a party's failure to perform a contractual obligation causes damage to a third party does not automatically entail delictual liability towards that third party. As set out in *Bail*, in order to establish delictual liability resulting from the faulty performance of a contractual obligation, it must be shown that the defendant has breached a legal duty towards the third party plaintiff (at p. 581). [**BOA Tab 4**]

[48] *Savard v. 2329-1297 Quebec inc.*, (2005) R.J.Q. 1997 (Que. C.A.), at p. 2012 [**BOA Tab 22**]

C. Diametrically Opposing Approaches to Auditor Liability

53. As a result of the decision of the Court of Appeal in this case, there now exist two diametrically opposing approaches in Canada to auditor liability to third parties:

> **Quebec:** Quebec auditors, if negligent, can be subject to indeterminate liability
>
> **Rest of Canada:** auditors, if negligent, are not subject to indeterminate liability.

54. Although Canadian common law and Quebec civil law need not necessarily be "in sync" in all situations, the diametrically opposed positions regarding auditor liability raise serious concerns in light of the fact that an auditor's position and role is the same throughout the country and in light of the fact that accounting standards and norms are also similar in every province.

55. The disparity in auditor exposure leaves little choice for Quebec auditors – they will move their services and therefore availability away from the province of Quebec and make certain that final review of financial statements occur anywhere but Quebec.

Issue 3: Can Corporate Directors Avoid the Consequences of Ignoring their Primary Obligations and Illegal Acts?

A. Directors' Not Auditors' Financial Statements

56. The duty to prepare financial statements in accordance with GAAP rests primarily on the directors of a corporation.[49] It is incumbent on directors, not auditors, to make the necessary enquiries and to obtain the relevant information to approve and place before the shareholders, at the annual meeting, financial statements that are in accordance with GAAP.

57. Coupled with the obligation of good faith, diligence and vigilance in monitoring and directing the company's affairs, a director is deemed to know what reasonable inquiries would disclose.[50]

58. The role of the auditor is to review, for the benefit of the shareholders who appoint them, whether the persons who are primarily entrusted with the duty to prepare financial statements

[49] *NB Act*, s. 100
[50] *Peoples Department Store v. Wise*, [2004] 3 S.C.R. 461, at para. 67 [**BOA Tab 17**]

and direct the company's affairs, have properly presented the financial statements in accordance with the principles required by the governing company's Act[51]:

> ...the primary obligation with respect to corporate financial statements falls upon the board and management rather than on the auditors.[52]

59. The statutory structure for corporate governance which defines the roles, responsibilities, and relationship of the directors, auditors and shareholders to each other with respect to the financial statements is common to all companies across Canada, including Quebec[53].

B. Directors Sued – Court Concludes Director Improperly Passive

60. On July 30, 2008, Justice Lemelin ruled on the Trustee's petition seeking reimbursement of dividends against one director (Gambazzi). Justice Lemelin concluded he had not conducted himself as a reasonable and responsible director – she therefore rejected his defense that he had relied on the auditor's report when he authorized the dividends. She also noted, in particular:

> Generally speaking, the evidence revealed that Castor's entire board was entirely passive, limiting itself to looking at the numbers without questioning, controlling or verifying.[54]

C. Respondent Director Claims Indemnity from Auditor – "I was Ignorant"

61. In agreeing that the Respondent should be fully indemnified (the court even refused to deduct the dividends improperly declared due to Castor's long term insolvency) the courts below came up with an "outside director" v. "inside director" scenario, and said the Respondent discharged his responsibilities as a director and had acted with due care and diligence because:

- the Respondent was an "outside director" as opposed to an "inside director".
- as an outside director, the Respondent did not need to know the company's nuts and bolts and could reasonably discharge his responsibilities by relying on the officer's and auditors' representations.[55]

D. Court Says Director Can Pass Off Responsibility and Liability for Primary Obligations

62. In *Peoples Department Store v. Wise*, this Honourable Court confirmed directors and officers will not be held to be in breach of the duty of care under the *CBCA* if they act prudently and on a reasonably informed basis – the standard of care is an objective (not a subjective) one.

[51] *Hercules, supra*, at para. 48 **[BOA Tab 11]**
[52] McGuinness K.P., *Canadian Business Corporation Law*, at p. 955 **[BOA Tab 31]**
[53] *Business Corporations Act*, R.S.Q. c. 31.1, chapter VII, ss. 225-239
[54] *RSM Richter v. Gambazzi*, 2008 QCCS 3437, at para. 83 **[BOA Tab 21]**
[55] Judgment of Court of Appeal below, at paras. 400, 404 **[Tab 4C]**

A director's conduct is not to be assessed by what his/her skills or knowledge happens to be. Rather, it is to be assessed by what those skills and knowledge should be.[56]

63. By focusing on the distinction between an "internal" and an "external" director the courts below re-introduced, through a juridical back door, a subjective analysis/test to determine reasonableness and prudence. By applying this defunct analysis, the Court of Appeal allowed the Respondent director, who failed in his duties to keep abreast of the company's affairs, to himself escape out that back door, by turning around and suing the auditors for reliance on the audit opinion (based on fake financial statements given to the auditor), despite the fact that the primary responsibility for the financial statements and for monitoring the affairs of the company rested with the directors.[57]

64. By granting leave in this case, this Honourable Court will have the opportunity to not only address whether a lower subjective standard can or should be applied to an "outside director's" failure to monitor his company's affairs, but also whether a person primarily entrusted with a duty ("primary debtor" – director) can shift his/her liability to someone whose role is to review for others ("watchdog" – auditor) that director's work? Are the SCC *Bilodeau*[58] principles stating that a "primary obligor" cannot hold the "watchdog" liable for failure to watch no longer applicable?

65. The impact of the decision of the Court of Appeal on corporate governance cannot be ignored:

- Director's ignorance and indolence is rewarded.
- Director inquiries are discouraged – directors to just sit there idle, listen and not ask questions.
- Two standards of director diligence (internal v. external) are created, based on personal characteristics and knowledge, re-introducing a subjective element.
- It is inconsistent with the statutory roles and responsibilities of directors and auditors.
- The statutory corporate scheme of checks and balances is modified.
- All who invest in, and rely on, the prudent operation of the company and its proper direction and oversight are threatened;
- Reliability of, and responsibility for, corporate financial disclosure is diminished.

[56] [2004] 3 S.C.R. 461, at paras. 63, 67 ("*Wise*") **[BOA Tab 17]**
[57] See s. 100 of the *NB Act*.
[58] *Bilodeau v. Bergeron & Fils Ltd*, [1975] 2 S.C.R. 345 **[BOA Tab 6]**

CONCLUSION: IMPORTANCE OF AUDITORS TO CANADA; AVOIDANCE OF FUTURE UNNECESSARY LITIGATION

66. Auditors play an integral corporate role to corporate success – and to the success of Canadian corporations abroad. The question of what auditors across Canada are liable for and where they are liable (what law) is crucial to the well-functioning of Canada's economy. Bottom line:

- is Canada a safe and regulated place to do business, because an important part of doing business is the accounting and auditing function
- what happened here will happen again; Canada needs clear rules on what law applies in such situations.

67. Until the law is clarified by this Honourable Court it is a juridical inevitability that longer trials will eclipse this one – though this one is a long one:

- 12 years;
- testimony of a single plaintiff-side witness more than 3 years on the stand, 4 days a week, 3 weeks out of 4, 10 months per year – you could start law school, graduate, with 1 witness still testifying;
- in the 9th year of the trial, the trial judge took ill and had to be replaced;
- the case is on its third Case Management judge;
- on one side 7 lawyers for the plaintiffs, 8 for the defendants, and a further 10 with watching briefs for "pending lawsuits"[59].

68. The fact that this is indeed a test case, and that there are "pending lawsuits" following this is important – if only because of the appropriate and efficient allocation of Canada's judicial resources. This involves some 100 claims, of which 39 active files await a decision on this test case, ranging from $452K to $100M[60]. And of further importance, this test case "has a binding effect [for the common issues only] on all pending lawsuits."[61]

69. Clear corporate governance principles, as enunciated and clarified by Canada's highest court, will provide greater certainty in Canada's legal system, and by virtue of that greater certainty will reduce unnecessary litigation overall – to the benefit of all.

[59] Trial Judgment below, at paras. 7, 19, 22 , 32, pg. 753 **[Tab 4A]** Case Management judge no. 3 started the trial.
[60] Trial Judgment, Annex A **[Tab 4A]**
[61] Trial Judgment below, at para. 36 **[Tab 4A]**

PART IV – SUBMISSIONS ON COSTS

70. The Applicants request costs in the cause, herein. In the particular setting of the present test case, this Honourable Court will also have an opportunity to review decisions below that defendants pay all costs related to common issues.

PART V – RELIEF REQUESTED

71. The Applicants request that Leave to Appeal be granted, with costs in the cause.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 29th day of August, 2013.

Eugene Meehan Q.C.

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PART VI – TABLE OF AUTHORITIES

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