LIVENT: THE SUPREME COURT AND BEYOND

By

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Introduction

In December 2017, the Supreme Court of Canada delivered the final act in the ongoing drama that followed the demise of Livent Inc.[1] The Court split over whether or not to impose negligence liability on Livent's auditor, Deloitte & Touche LLP (Canada), for failing to discover, report, or shut down the fraud perpetrated by Livent's executive management. The decision partially reverses the Ontario Court of Appeal, and as a result, reshapes auditor's liability in Canada and forever changes the *Anns/Cooper* test for duty of care into the *Anns/Cooper/Livent* test.[2]

This paper considers the impact of *Deloitte & Touche v Livent*.[3] For those unfamiliar with the story, the first part of the paper summarizes the key facts. Part 2 of the paper traces the litigation through the Ontario civil court system and into the Supreme Court of Canada. In part 3, the majority and dissenting opinions are compared. Finally, a foreshadowing of *Livent's* legacy is revealed through a review of recent provincial appellant level decisions that interpret and apply *Livent*.[4]

I. What Happened at Livent?

In 1989, Garth Drabinsky[5] and Myron Gottlieb formed a partnership known as MyGar and purchased the live entertainment division of Cineplex.[6] This was the beginning of the vertically integrated live entertainment business[7] that would ultimately become Livent. It developed, produced and housed live theatrical works in Canada and the United States through the 1990's. MyGar hired Deloitte & Touche (Canada) as its auditor; a position Deloitte would hold from 1989 until Livent's insolvency in 1998.[8]

MyGar went public in Canada in 1993 as Live Entertainment Corporation of Canada Inc. (Livent), registered with the US Securities and Exchange Commission in 1995 and, went on to

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[1] Deloitte & Touche v. Livent Inc., [2017] 2 S.C.R. 855, 2017 SCC 63 (Can.) *modifying* Livent Inc. v Deloitte & Touche, [2016]131 O.R.3d 784, 2016 ONCA 11 (Can.).

[2] *Anns/Cooper* is the collective reference to the cases used to develop the test for assessment of new duty of care categories: Anns v. Merton London Borough Council, [1978] A.C. 728 (H.L.) (U.K.) *modified by* Cooper v. Hobart, [2001] 3 S.C.R. 537 (Can.). *See also* Hill v. Hamilton-Wentworth Regional Police Services Board, [2007] 3 S.C.R. 129, 2007 SCC 41 (Can.); Childs v. Desormeaux, [2006] 1 S.C.R. 643, 2006 SCC 18 ¶15 (Can.).

[3] 2017 SCC 63 (Can.).

[4] *Id.*

[5] Garth Drabinsky was an Ontario lawyer who was disbarred following his criminal convictions in the Livent fraud: http://www2.lsuc.on.ca/LawyerParalegalDirectory/loadDisciplineSummaryDetailsPage.do?iD=dytaybE%2fz5g%3d&startPoint=0&currentPoint=0&sublistIndex=1 and stripped of his Order of Canada http://www.cbc.ca/news/canada/toronto/garth-drabinsky-loses-appeal-to-reclaim-order-of-canada-1.2899957 .

[6] Cineplex was a movie theatre business where both Drabinsky and Gottlieb worked; it owned the Pantages Theatre in Toronto and the Canadian rights to produce The Phantom of the Opera*:* R. v. Drabinsky, [2011] 107 O.R. 3d 595, 2011 ONCA 582 ¶ 7 (Can.); Drabinsky]; Livent Inc. v Deloitte & Touche, 2016 ONCA 11 ¶10 (Can.).

[7] *See* Anthony Vickery, *Accounting Fraud at Live Entertainment Canada, Incorporated, 1993-1998*, 7(2) INT'L J. ART MGMT 15, 15-16 (2005) (referring to the old Hollywood film studio system popular in the 1930's which brought together creation, production and distribution through the ownership of theaters)

[8] Livent Inc. v. Deloitte & Touche, 2016 ONCA 11 ¶ 4 (Can.).

present Showboat,[9] Music of the Night and Sunset Boulevard while expanding its theatre holdings to include the Lyric and Apollo in New York and the Oriental in Chicago.[10] Drabinsky and Gottlieb continued to control Livent's management and operation even after it went public.[11] In the mid-90's, the burden of the fixed costs associated with theatre renovation blended with the more intangible costs of show production provided the catalyst for the fraud that would see Livent's financial statements and press releases misrepresent the income and liabilities of the company until its catastrophic failure in 1998.

The actual fraud took a variety of forms over more than five years. There were kickbacks paid to Gottlieb and Drabinsky by suppliers through inflated invoices for theatre and production costs.[12] Pre-production costs were rolled over from one show to the next to exaggerate the originating show's profitability.[13] Drabinsky and Gottlieb surrounded themselves with employees, directors, officers, lawyers and auditors who facilitated or enabled their fraud.[14] Together their actions produced an unrealistic picture of profitability by inflating income and deferring expenses.

Ultimately, it was the one-off revenue transactions[15] that brought down Livent's house of cards; early reporting of future payments (not yet due or received) became a point of conflict between Gottlieb and the auditors. In particular, the 1997 sale of the air rights over the Pantages Theatre contained such broad penalty-free cancellation rights in favor of the purchaser (Dundee Realty Corp.) that recording its future payments as revenue finally forced Deloitte to pull its auditor head out of the sand, at least temporarily. Those inside Deloitte became concerned about compliance with generally accepted accounting principles[16] but when Deloitte was threatened with the loss of the Livent and Dundee audits,[17] it succumbed to the pressure and negotiated a compromise that saw a still inaccurate comfort letter and press release further obfuscate the Livent financial picture for investors.[18]

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[9] American Theater Wing's Tony Awards Official Website, https://www.tonyawards.com/p/tonys_search (Showboat received 5 Tony Awards in 1995).
[10] *Livent,* 2016 ONCA 11 ¶ 13.
[11] R. v. Drabinsky, 2011 ONCA 582 ¶ 10.
[12] *Livent,* 2016 ONCA 11 ¶ 20.
[13] *Id.* ¶¶ 24-26.
[14] *Livent,* 2016 ONCA 11 ¶ 19, 251, 253-66 (Gordon Eckstein (Senior Vice President of Finance), Raymond Cheong (Livent's Manager of Information services who modified the accounting software), Dianne Winkfein (–Livent Controller), Maria Messina, (a Deloitte partner on the Livent audit until 1996, quit to join Livent as VP of Finance and became Chief Financial Officer), the directors on the audit committee, Smith Lyons LLP (their law firm) and of course Deloitte); R. v. Drabinsky, 2011 ONCA 582, ¶ 15 (Can.). *See* Peter Small, *Knew It Was Wrong But Did It Anyway: Livent Manager*, THESTAR.COM , July 16, 2008, http://www.scc-csc.ca/case-dossier/info/dock-regi-eng.aspx?cas=36875 ; Joseph Weber, *At Livent is Fraud the Thing?* Bloomberg, Feb. 15, 1999, https://www.bloomberg.com/news/articles/1999-02-14/at-livent-is-fraud-the-thing .
[15] Various sponsorships, naming rights, production rights etc. (valued at about $40 million CAD).
[16] *Livent,* 2016 ONCA 11 ¶¶ 251,260, 270-84 (Rod Barr, a Senior Canadian Partner in Deloitte's National Office, Bob Wardall and Peter Chant, Advisory partner on Livent file; after opposition Gottlieb forced Deloitte to change the audit team).
[17] *Livent,* 2016 ONCA 11 ¶¶ 248, 251-52.
[18] *Id*. ¶¶ 268-69, 284.

After a new investor purchased 12% of Livent in 1998,[19] the accounting irregularities were quickly identified and unraveled, affecting transactions dating back to 1990. Deloitte was forced to withdraw its audit opinions for 1996 and 1997. Gottlieb and Drabinsky were fired for cause and Livent filed for insolvency protection in November of 1998.[20] Restated financial statements for 1996 and 1997 (plus one quarter of 1998) would eventually show more than $98 million (CAD) in accounting "irregularities".[21]

At the conclusion of their criminal appeals in 2008, Drabinsky and Gottlieb were convicted of fraud and forgery, they received five, and four year sentences, respectively.[22] Partners at Deloitte were disciplined by Chartered Accountants of Ontario,[23] as was the Chief Financial Officer who plead guilty to federal felony charges in the United States[24] and became a witness for the Crown in Canada. Civil litigation was commenced in both Canada and the United States.[25]

II. The Civil Litigation

Class actions were filed against Deloitte (and others) by investors in the United States,[26] and once settled, a bar order issued by the New York District Court released Deloitte from all claims of class members (investors) or anyone claiming on behalf of them.[27]

Livent's receiver[28] commenced a Canadian civil action in negligence and breach of contract against Deloitte in 2002. The basis of the claim was that Deloitte's failure to discover the

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[19] *Livent,* 2016 ONCA 11 ¶ 38; R. v. Drabinsky, 2011 ONCA 582 (Michael Ovitz, a prominent U.S. entertainment business person).

[20] Companies' Creditors Arrangement Act, R.S.C. ch. C-36 (1985); Livent Inc. (Re), [1998] 42 O.R.3d 501(Can.) (leaving ticket holders without recourse).

[21] *Livent,* 2016 ONCA 11 ¶ 45.

[22] R. v. Drabinsky, 2011 ONCA 582, ¶¶188 - 189. Charges against Myron Gottleib by the Ontario Securities Commission were settled following criminal conviction: Ontario Securities Commission Website, http://www.osc.gov.on.ca/documents/en/Proceedings-SET/set_20140822_drabinskyg.pdf ; Some Drabinsky matters remain at issue in April 2017: Ontario Securities Commission Website, http://www.osc.gov.on.ca/en/Proceedings_rad_20170404_drabinsky.htm . *See also* SEC v. Drabinsky et al., No. 99 Civ. 0239 (S.D.N.Y.).

[23] *See* ICAO Discipline Committee Reasons For Sanction and Costs in the Matter of Douglas Barrington, Anthony Power and Claudio Russo, Sept 27, 2007. https://ebusiness.cpaontario.ca/discipline/ReturnFile_Action.cfm?Required=barrington_order ; Canadian Business *Livent Auditors Appeal Misconduct Ruling,* June 6, 2008 http://www.canadianbusiness.com/blogs-and-comment/livent-auditors-appeal-misconduct-ruling/ ; Barrington v. Institute of Chartered Accountants of Ontario, [2011] 333 D.L.R. 4th 401, 2011 ONCA 409 (Can.).

[24] Maria Massina. *See* Floyd Norris, *Editorial Observer; When Former Auditors Help Commit Fraud,* THE NEW YORK TIMES, Jan. 17, 1999, http://www.nytimes.com/1999/01/17/opinion/editorial-observer-when-former-auditors-help-commit-fraud.html ; Others settled similar felony charges as well: *see* SEC Press Release 99-3, Jan. 13, 1999 https://www.sec.gov/news/press/pressarchive/1999/99-3.txt

[25] *Livent,* 2016 ONCA 11 ¶ 48.

[26] In Re Livent, Inc. Securities Litigation, 78 F. Supp. 2d 194 (Fed. Crt. NY, 1999)

[27] *Livent* 2016 ONCA 11 ¶ 166. *See* King v. Drabinsky et al, 2007 CanLII 3062 (ONSC) (Can.) (Canadian enforcement proceedings related to the U.S. investors' damages)

[28] Special receiver, Raymond Doroniuk, obtained permission of the bankruptcy court to commence the action; the cause of action was accepted as a bankruptcy asset of the corporation. The receiver, Ernst &Young (E & Y), declined to consider whether or not Livent had any potential claim against Deloitte on the basis of an alleged conflict of interest. On November 16, 2001, Doroniuk was appointed special receiver to manage "the asset of Livent Inc., being the

fraud, reveal it or resign, fell below the standard of care required of an auditor and breached the terms of the auditor contract. It was negligent performance of a service. The claim was not framed as negligent misrepresentation and did not focus on who relied on the numbers in the statements because, of course, most of the management knew the numbers were false. The allegation was that Deloitte improperly allowed Livent to continue to operate well after it knew or should have known that something was seriously wrong, thereby increasing the eventual liquidation deficit.[29] The distinction between negligence and negligent misrepresentation was disputed by Deloitte.

Deloitte argued that the characterization of the claim as negligence, and the plaintiff as Livent, was a sham to disguise the true plaintiffs – being the investors, and the true cause of action – being negligent misrepresentation, both of which would be barred by the US settlement order or blocked by the seminal Canadian auditor's liability case of *Hercules Managements Ltd. v Ernst & Young*.[30] Preliminary proceedings (relating to security for costs,[31] discovery[32] etc.) and parallel actions (particularly the criminal actions noted above) delayed the matter for more than a decade and it eventually went to trial in 2013.

The trial judge[33] painstakingly divided up the fraudulent transactions into categories – those matters before the 1996 audit which he believed could not have been detected by Deloitte, those matters covered in the 1996 audit that should have been detected by Deloitte but which lack of detection did not cause Livent damage, and those matters covered in the 1997 audit that should have been detected and acted upon by Deloitte which lack of action *did* cause Livent damage.[34] Justice Gans rejected Deloitte's position that the US settlement barred Livent's claim and found that Livent's cause of action was a negligence claim and not a disguised negligent misrepresentation claim on behalf of shareholders or investors. He also rejected attribution arguments that would have attributed the Drabinsky/Gottlieb fraud to Livent and blocked it from profiting from "its own fraud".[35] Justice Gans' reasons addressed many fundamental tort concepts including duty, standard of care, public policy, indeterminate liability, causation, remoteness and contributory negligence, as well as defense arguments of ex turpi causa, attribution and

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potential claim or claims of Livent Inc., if any, against Deloitte". Livent. Inc. (Special Receiver) v. Deloitte & Touche, 2010 ONSC 2267 ¶ 55 (Can.).

[29] *Livent,* 2016 ONCA 11 ¶¶ 62, 306, 383 (Loss = Actual Liquidation Deficit – Estimated Liquidation Deficit determined as of measurement date).

[30] Hercules Management v. Ernst & Young, [1997] 2 S.C.R. 165, ¶ 59 (Can.) (which held that the corporation was owed a duty of care by the auditors not the shareholders).

[31] Livent. Inc. (Special Receiver) v. Deloitte & Touche, 2010 ONSC 2267 (CanLII); Livent. Inc. (Special Receiver) v. Deloitte & Touche, 2011 ONSC 648 (CanLII), Since Livent was in receivership an order to post security for costs required them to find interim financing under the super-priority rules of the Bankruptcy and Insolvency Act: Deloitte, Memorandum of Argument, S.C.C. Case No. 36875 ¶ 15 http://www.scc-csc.ca/WebDocuments-DocumentsWeb/36875/MM010_Applicant_Deloitte-&-Touche.pdf .

[32] Livent Inc. v. Deloitte & Touche, 2009 CanLII 2324 (ON SC); Livent. Inc. (Special Receiver) v. Deloitte & Touche, 2012 ONSC 7007 (CanLII), Livent Inc. v. Deloitte & Touche LLP, 2013 ONSC 621 (CanLII).

[33] Livent v. Deloitte & Touche LLP, 2014 ONSC 2176 (Can.) [*Livent SC*] Gans, J.

[34] *Livent,* 2016 ONCA 11 ¶ 5.

[35] Ex turpi causa is a civil defense that invalidates an otherwise valid and enforceable tort action in order to preserve the integrity of the legal system. It blocks damage awards that would allow a person to profit from illegal or wrongful conduct: British Columbia v. Zastowny, [2008] 1 S.C.R. 27, 2008 SCC 4, ¶ 20 (Can.) (relying upon Hall v. Hebert [1993] 2 S.C.R. 159, 169 (Can.)).

identification theory, all of which would be revisited by the Court of Appeal. Judgment of $84,750,000 (plus pre judgment interest) was awarded to Livent.

Both parties appealed. Deloitte disputed all the findings especially those related to the 1996 and 1997 breach of standard[36] and Livent disputed the 1996 lack of causation finding.[37] The Ontario Court of Appeal unanimously upheld the trial judgment in February 2016. Both appeals were dismissed and Justice Blair (writing for the Court) affirmed Justice Gans' reasons on attribution, true plaintiff, duty, standard of care, damages and the application of *Hercules*.

The Court of Appeal judgment was stayed[38] pending the outcome of Deloitte's leave application, which primarily relied on five grounds.[39] First, Deloitte argued that the lower courts had effectively "gutted" *Hercules* by allowing Livent to recover damages that would ultimately benefit the shareholders, investors and creditors. This was the "sham" argument heavily laced with the public policy risk of indeterminate liability if auditor liability was extended to investors and creditors. Next, Deloitte maintained that the lower courts had improperly changed the standard of care to incorporate new regulations and a new obligation to resign. Third, Deloitte argued *ex turpi causa*[40]– saying that fraud was so pervasive throughout Livent's management that it had to be attributed to the corporation and used to block the action. The quantification of damages was criticized as a misapplication of the "deepening insolvency" principle.[41] Finally, Deloitte relied on the tried and true argument that prevailed in *Hercules* – that the public policy implications for the auditing industry would be devastating if the Court of Appeal reasoning was affirmed.

Leave to Appeal was given[42] and the Supreme Court of Canada granted intervenor status to the Chartered Professional Accountants of Canada (CPCA) and to the Canadian Coalition for

[36] *Livent*, 2016 ONCA 11 ¶ 6.
[37] *Id*. ¶ 7.
[38] Livent v. Deloitte & Touche, 2016 ONCA 395 (Can.). In this round, Livent did not appeal the lack of causation finding for1996 audit; a failure the Supreme Court relied upon when limiting the foreseeable damages associated with the comfort letter duty: Deloitte & Touche v. Livent, 2017 SCC 63 ¶ 56.
[39] Factum of the Appellant (Deloitte), Deloitte LLP v. Livent Inc., No. 36875 ¶¶ 12, 30 (S.C.C., Sept 21, 2016) http://www.scc-csc.ca/WebDocuments-DocumentsWeb/36875/MM010_Applicant_Deloitte-&-Touche.pdf [Deloitte factum].
[40] Hall v. Herbert, [1993] 2 S.C.R. 159, 171, 184 (Can.)(meaning from dishonorable behavior an action does not rise – and recognized as a defense in a tort action which places the burden on the defendant to prove that illegal or immoral conduct of the plaintiff should preclude the plaintiff's action). *See generally* (on insider fraud): Jeffrey Simser, *Culpable insiders – the enemy within, the victim without*, (2014) 21(3) J. FIN. CRIME 310-320, https://doi.org/10.1108/JFC-11-2013-0068 .
[41] *Livent*, 2016 ONCA 11 ¶ 331 (defining deepening insolvency as "artificial prolongation of a corporation's existence past the point of insolvency" or "an injury to [a debtor's] corporate property from the fraudulent expansion of corporate debt and prolongation of corporate life" from John Tully, *Plumbing the Depths of Corporate Litigation: Reforming the Deepening Insolvency Theory*, (2013) U. ILL. L. REV. 2087, 2089, (2013)). *See also* Jassimine Girgis, *Deepening Insolvency in Canada*, 53 MCGILL L. J. 167-197, ¶¶ 4-8, 15-24 (2008) (defining the theory and its history in Canada).
[42] Deloitte & Touche v. Livent Inc., Through its Special Receiver and Manager Roman Doroniuk, 2016 CanLII 33999.

Good Governance (CCGG).[43] In December 2017, the Supreme Court released its split decision, partially reversing the Ontario Court of Appeal.[44]

Justices Gascon and Brown wrote the majority opinion on behalf of themselves and Justices Karakatsanis and Rowe. The majority described the case as an opportunity to affirm and refine the analytic framework used to decide cases of negligent misrepresentation or negligent performance of a service,[45] and did not dwell on it as an auditor's liability case. The case was used to create a universal template for application in all tort duty of care cases, well beyond the auditor context. The majority offered direction on how to interpret and apply previously recognized duties by emphasizing context and purpose as the necessary lens through which to view every component of the *Anns/Cooper* test. They criticized the trial judge and the Court of Appeal for overly broad applications of the previously recognized duty between auditor and client in *Hercules* and restricted *Hercules'* application to the statutory audit context. The comfort letter or press release were distinct work products not present on the *Hercules*' facts.[46] Damages were confined to those flowing from the audit and judgment was cut in half.

Chief Justice McLachlin (as she then was) wrote the dissent on behalf of herself and Justices Wagner and Cote and would have reversed the Court of Appeal entirely. Their analysis focused on the policy concerns over remoteness and indeterminacy of the injury in the context of pure economic loss. They are at odds with the majority over the interpretation and application of the concepts of indeterminate and undetermined liability[47]. They also differ on the characterization of information versus advice, burden of proof, and the application of stage two of the duty of care analysis in cases of existing categories.[48]

A closer examination of both majority and dissenting opinions follows in Part Three's assessment of three central questions.[49]

III. Questions for the Supreme Court

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[43] Supreme Court of Canada Docket Case No. 36875, http://www.scc-csc.ca/case-dossier/info/dock-regi-eng.aspx?cas=36875 (Toronto Dominion Bank sought but was denied intervenor status). The CPA strongly argued indeterminate liability, persuading the minority but not the majority.

[44] Deloitte & Touche v. Livent, 2017 SCC 63. Webcast of the Supreme Court argument is available at http://www.scc-csc.ca/case-dossier/info/webcast-webdiffusion-eng.aspx?cas=36875 ;

[45] Deloitte & Touche v. Livent, 2017 SCC 63 ¶ 1.

[46] Hercules Management v Ernst & Young, [1997] 2 S.C.R. 165, ¶ 52.

[47] Deloitte & Touche v. Livent, 2017 SCC 63 ¶¶ 43, 44, 76, 79-80 (majority suggesting so much overlap in the analysis that it is difficult to see how indeterminacy could survive a robust stage one proximity analysis).

[48] *Id.*, ¶¶ 22, 85-88, 95. Stage two applies residual policy concerns to negate liability in some situations where a prima facie duty of care is found to exist after stage one: *See Childs*, 2006 SCC 16 ¶ 47.

[49] *See* Shelley McGill, *Livent or "Dead Event? – A Primer on Livent v Deloitte and What to Expect from the Supreme Court of Canada*, 48 Acad. Legal Stud. In Bus. Nat'l Proc. ____ (2017), https://alsb.org/procedings/2017-proceedings/dp-2017-mcgill-livent-or-dead-event/ (previous paper by this author identifying the three central questions). For perspectives of other authors examining *Livent see*: Andrea Laing & Adam Nickerson, *Deloitte & Touche v. Livent Inc. (Receiver of) : The Supreme Court of Canada Affirms Duty of Care but Reduces Auditor's Damages in Livent Decision*, (2018) 33 (2) BANKING & FIN. L. REV. 293; Geoff R. Hall et al., *Can You Rely on the Livent Undertaking? An Analysis of the Implications of Deloitte & Touche v. Livent*, (2019) 89 S.C. L. REV. (2d) 105.

Following the Court of Appeal decision, the Supreme Court of Canada had three questions to answer:[50]

Question 1: Did *Hercules* settle the law that an auditor owes a corporate audit client a duty of care or must each auditor/client relationship be assessed separately to determine if a duty of care is owed?[51]

Question 2: How far should the public policy argument of indeterminate liability be applied to auditor negligence analysis before the public policy reasons for having an audit are extinguished?[52]

Question 3: What are the limits of corporate separate legal identity and the use of identification theory in the context of ex turpi causa's shield of auditors?[53]

Context, purpose and public policy dominate both the majority and dissenting opinions but their positions on these questions are very different from each other. The dissent is prepared to gut the statutory audit and invites case-by-case judicial interpretation of policy priorities, sacrificing legal certainty.[54]

A. Question One: *Hercules* and Previously Recognized Duty of Care

Hercules remains binding authority governing an auditor's duty of care but only in relation to a statutory audit. Other non-audit services provided by an auditor to the audit client must be evaluated with a fresh *Anns/Cooper* analysis to determine if a duty is owed. This confines consideration of relationship and residual public policy factors to assessments of new duties.

Before deciding if the *Hercules* category applied to the *Livent* relationship, the majority clarified the framework of the two-stage *Anns/Cooper* duty of care test.[55] They emphasized that the first stage of the test requires separate assessments of proximity[56] and foreseeability.[57] Normally, proximity, the most demanding hurdle, would be evaluated first[58] and this is the only place in stage one where previously recognized categories (or precedents) are relevant. An

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[50] *McGill*, *supra* note 49, at 16.
[51] *Id*. at 9.
[52] *Id.* at 12.
[53] *Id*. at 15.
[54] James R. Maxeiner, *Some Realism About Legal Certainty in the Globalization of the Rule of Law*, 31(1) HOUSTON J. INT'L L. 27, 30 (2008) (A rule-based society benefits from legal certainty and predictability, A legal system that provides legal certainty guides those subject to the law and permits those subject to the law to plan their lives with less uncertainty. It protects those subject to the law from arbitrary use of state power).
[55] Deloitte & Touche v. Livent, 2017 SCC 63 ¶¶ 16, 22-23 (*Hercules* is not to be relied upon for the framework of the duty test; only for establishing a auditor's duty of care in relation to a statutory audit). The dissent embarks on a full two-stage duty of care analysis without giving Hercules credit for establishing a pre-existing category but considers *Hercules* instructive as to the test to be applied (¶¶ 144, 147). The dissent seems to lump proximity and reasonable foreseeability of injury into one assessment of "scope of duty of care" (¶ 149) and seems to consider shareholders rather than the audit client in the duty analysis (para 161). Duty fails because the Livent's failure to prove shareholder reliance on the statutory audit (¶¶ 170, 173).
[56] *Id*. ¶¶ 20, 25 (closeness and directness of the relationship to reasonably foresee reliance).
[57] *Id.* ¶ 22 (reasonability foreseeability of injury separate from the more onerous proximity).
[58] *Id.* ¶¶ 24, 34 (for cases of negligent misrepresentation and negligent performance of a service).

established category eliminates the need for a fresh finding of proximity. Previously established categories of proximity must not be applied broadly to new cases based on the identities of the parties alone. They should only be applied when the contexts are analogous.[59] In negligent misrepresentation and negligent performance of a service involving pure economic loss, this means the nature and purpose of the undertaking and the reliance upon it must be the same or analogous to those of the case which previously recognized the category or it cannot be used in place of a full proximity assessment.[60] Proximity, and in particular reliance, is purpose specific.

Previously recognized categories are not exempt from the second component of stage one, assessment of the reasonable foreseeability of injury.[61] Again, this involves consideration of purpose because the plaintiff has no reasonable right to rely on a defendant for any purpose other than those undertaken. If both proximity and foreseeability are found, then stage one results in a prima facie finding of duty of care.

Stage two of the *Anns/Cooper* test examines residual policy reasons[62] for negating a prima facie duty. Since a full proximity analysis includes assessments of policy considerations arising from the relationship such as claimant, value and temporal indeterminate liability,[63] the majority holds that it would typically not be relevant for existing categories. Even with new categories, a stage two negation of a stage one prima facie duty of care should be rare.[64]

Analytically, it was important for the majority to separate the 1997 statutory audit from the comfort letter/press release. They were different undertakings and their respective purposes and reasonable reliance were different.[65] Therefore, each undertaking followed a separate path through the newly clarified *Anns/Cooper/Livent* analysis. The majority found *Hercules* analogous to the statutory audit in *Livent*[66] and, therefore dispensed with a full proximity analysis and stage two residual policy considerations for the audit.[67] The only de novo assessment of the statutory audit was for reasonably foreseeability of injury and the majority found that it was reasonably foreseeable that the company would rely on the audit to uncover management fraud and the deepening insolvency was a reasonable consequence of undiscovered fraud in a negligent audit.[68] It held Deloitte liable for the negligent audit.

The path was different for the comfort letter. The majority did not find *Hercules* analogous to the *Livent* comfort letter/press release because this was done for the purpose of soliciting investment and not to overseeing management or uncover fraud (recognized purposes in *Hercules*

[59] *Id.* ¶ 28.
[60] *Id.* ¶ 30.
[61] *Id.* ¶ 32 (whether the injury is an objectively reasonable consequence of the negligence); The fact that something is possible does not mean that it is reasonably foreseeable: *Childs*, 2006 SCC 18 ¶ 29.
[62] *Id.* ¶¶ 37,38, 40 (outside the relationship of the parties-legal system or society as a whole; burden of proof is on the defendant)
[63] *Id.* ¶¶ 38, 42, 68.
[64] *Id.* ¶ 41.
[65] *Id.* ¶¶ 10, 47, 51, 52-53.
[66] *Id.* ¶¶ 58, 62 (overseeing management and uncovering management fraud).
[67] *Id.* ¶ 67.
[68] *Id.* ¶¶ 63-66.

as affirmed in *Livent*).[69] Therefore, a full stage one and two *Anns/Cooper/Livent* analysis was completed. It failed both the proximity and foreseeability assessments of stage one because Deloitte did not undertake to provide the comfort letter for the purposes of overseeing management and therefore, it could not be reasonably relied upon by Livent for that purpose. Damages flowing from management fraud were not reasonably foreseeable.[70] The majority and dissent agreed on this analysis of the comfort letter and both rejected any duty owed to Livent to uncover fraud in providing the comfort letter and removed damages flowing from the comfort letter and press release from the Court of Appeal calculation.

B. Question 2: Public Policy and Indeterminate Liability

This is the issue on which the majority and dissent disagree most profoundly. The majority rejects and finds unnecessary[71] the interpretation, expanded analysis and application of indeterminate liability undertaken by Chief Justice McLachlin. The majority holds that a finding of indeterminacy at the damage stage strongly suggests that an error occurred at the duty stage.[72] The majority confines the assessment of indeterminate liability to the duty analysis by saying "any "indeterminate liability" that survives stage one of the *Anns/Cooper* framework presumably arises from risk against which the defendant voluntarily undertook to protect the plaintiff and therefore, may justly and fairly result in liability".[73] Even inside the duty analysis, the presence of indeterminate liability is not fatal – other factors may justify liability in spite of indeterminacy.[74]

While conceding that indeterminate liability is a legitimate residual policy consideration relevant in stage two of the *Anns/Cooper* analysis, the majority reminded that it is also part of the proximity analysis in stage one. Therefore, it should rarely, if ever, be applicable in stage two if it survived a robust proximity analysis in stage one; a misinterpretation of the meaning of the concept would have had to occur.[75] According to the majority, the dissenting opinion unnecessarily conducted a residual policy assessment for a recognized category, and then failed to confine its assessment of indeterminate liability to liability flowing from the specific purposes of a statutory audit.[76] Finally, the minority confused indeterminate with undetermined liability.[77]

Indeterminate liability only applies to liability that is impossible to ascertain, not liability that is undetermined (not ascertained yet) or significant (of high value). Indeterminacy may arise with respect to length of time, number of claimants or value. When examined through the lens of the purpose of the statutory audit as defined in *Hercules* and affirmed by them in *Livent,* the majority drew clear conclusions rejecting indeterminate liability of an auditor performing a statutory audit.[78]

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[69] *Id.* ¶¶ 59, 62.
[70] *Id.* ¶ 55.
[71] *Id.* ¶¶ 42, 44, 67.
[72] *Id.* ¶ 44.
[73] *Id.* ¶ 45.
[74] *Id.* ¶ 45.
[75] *Id.* ¶¶ 42-43.
[76] *Id.* ¶¶ 73, 75.
[77] *Id.* ¶¶ 72, 74.
[78] *Id.* ¶ 74.

- Temporal indeterminate liability does not exist because statutory audits must occur annually. Therefore, liability could not extend beyond one year when the following year's audit supersedes it.[79]
- Claimant indeterminate liability does not apply – the number of possible claimants is one. The dissent's confusion on this point flows from Deloitte's "sham" argument that the action is really for investors, creditors and shareholders. The majority is clear; *Hercules* denies a duty to shareholders and directs that the only clamant is the company, either on its own or as a derivative action.[80]
- Value of liability is determinable because the temporal and claimant liability is known. It could not exceed the losses of a single company which could be significant but predictable not indeterminate.

Along with affirming the purposes of a statutory audit, the determination findings are the most specific auditor's liability findings offered in the whole case and should help define the limits of future auditor liability claims.

The majority also rejects the minority's (and Deloitte's) attempt to insert indeterminate liability into the remoteness assessment of damages by reminding the former Chief Justice that remoteness looks at actual injury sustained by the claimant and not hypothetical "types" of injury considered reasonable.[81] In fact, the lengths to which the Chief Justice goes to deny liability[82] seem to extinguish the very foundation of the statutory audit and therefore cannot be upheld. In sum, it is clear that the majority will not allow the central purpose of the statutory audit to be undercut.[83]

C. Question 3: Corporate Separate Identity, Identification Theory and Ex Turpi Causa

All of Deloitte's defences require the fraudulent behaviour of wrongdoing directors and managers to be attributed to Livent using the corporate identification doctrine. The majority affirmed the attribution test set out in *Canadian Dredge & Dock Co v The Queen*[84] including the qualification that attribution is discretionary not mandatory; courts may refrain from applying it if it is not in the public interest to do so.[85] If application would render a recognized duty of care meaningless then it is not in the public interest to do so; of course this follows because policy considerations are already in the duty of care analysis.

Therefore, ex turpi causa (illegality) and contributory negligence fail because it would not be in the public interest to attribute the Drabinsky/Gotlieb fraud to Livent and thereby insulate an

[79] *Id.* ¶ 69.
[80] *Id.* ¶¶ 70-71.
[81] *Id.* ¶¶ 78-79, 142,165.
[82] *Id.* ¶¶ 95, 159, 162, 170 (distinguishing between information and acts, denying reliance, denying causation and shifting the burden of proof).
[83] *Id.* ¶¶ 86-88.
[84] [1985] 1 S.C.R. 662 (Can.).
[85] Deloitte & Touche v. Livent, 2017 SCC 63 ¶ 104 (overruling Hart Building Supplies Ltd. V Deloitte & Touche 2004 BCSC 55). *See* Darcy L. MacPherson, *Emaciating the Statutory Audit – A Comment on Hart Building Supplies Ltd v Deloitte & Touche*, (2005) 41 CAN. BUS. L.J. 471.

auditor from liability for the consequences of negligently failing to report the fraud they were hired to detect.[86] The dissent does not address attribution having rejected any auditor duty of care.

IV. The Livent Legacy

Livent's legacy is examined from two perspectives – its subsequent judicial interpretation and application and its message for the auditing community. The two are almost mutually exclusive. Much like the emphasis of the judgement itself, most of the judicial interpretation and application of the case focuses on its contribution to the analytic framework of the *Anns/Cooper* test for duty of care. The message to the auditing community must be mined from the judgment itself and any undisturbed findings of the Ontario Court of Appeal.

A. Subsequent Judicial Consideration

Six months after the release of *Livent*, the Supreme Court of Canada took the opportunity to apply its *Livent* duty of care pronouncements to *Rankin (Rankin's Garage & Sales) v. J.J.* .[87] *Rankin* is a case far removed from the auditing context involving drunken teenagers stealing a car from a commercial car lot. In *Rankin*, the majority cites *Livent* (along with *Cooper* and *Mustopha*[88]) as general authority for dispensing with a full *Anns/Cooper* analysis when a previous case recognizes an analogous duty of care.[89] *Livent's* most important contribution to *Rankin* is on the point that actually separates the majority and dissent – how to interpret and apply previously recognized duties. *Livent* stands alone as authority for "narrow" interpretation. Still, in an undeniably wide interpretation, the dissent suggests that a "defendant's acts causing foreseeable physical injury" is a pre-established category sufficient to dispense with the full analysis.[90] The majority rejects this overly broad interpretation of previous categories saying that "[s]uch an approach would be contrary to recent guidance from this Court that categories should be framed narrowly (see Deloitte [*Livent*], at para. 28)".[91]

Interestingly, Justices Gascon and Brown are the authors of both the majority opinion in *Livent* and the dissenting opinion in *Rankin*, and they apparently believe that the more important message from *Livent* on category interpretation is the emphasis on factors that justified establishing the category in the prior case. Depending on the particular factors and current circumstances, Brown and Gascon say that a category could be interpreted broadly or narrowly.[92] It seems *Livent* has not clarified or unified the treatment of established categories even for its authors.

Appellant courts in Ontario and British Columbia have considered *Livent* eight times in the year and half since its release. Ontario hosted all but one of the cases; and somewhat surprisingly,

[86] Deloitte & Touche v. Livent, 2017 SCC 63 ¶¶ 104, 108 (without attribution the mandatory provisions of the statutory contributory negligence provisions are not triggered: Negligence Act, R.S.O. ch. N.1, s 3 (1990) (Can.)).
[87] 2018 SCC 19 (Can.).
[88] *Mustapha v. Culligan of Canada Ltd.*, [2008] 2 S.C.R. 11, 2008 SCC 27 (Can.).
[89] *Rankin*, 2018 SCC 19 ¶18 (summarizing the complete analytic framework ¶¶ 17-20).
[90] *Id.* ¶¶ 69, 73.
[91] *Id.* ¶¶ 28, 73-74 (the majority and minority positions on breadth of a category).
[92] *Id.* ¶ 74.

only two of the case are from the accounting contexts.[93] The majority are appeals from summary judgment motions. Although most of the Ontario cases cite *Livent* for refining the analytical framework for duty of care analysis generally and, for the narrow interpretation to be given to prior categories, [94] *Livent* is also used to define indeterminacy,[95] confine identification theory,[96] and restrict damages.[97] Most often *Livent* dictates a full *Anns/Cooper/Livent* analysis in order to avoid the pitfalls of overly broad application of existing categories.

In *1688782 Ontario Inc. v. Maple Leaf Foods*,[98] the Ontario Court of Appeal unanimously overturned a decision that placed product liability for tainted meat within an established category. Relying on *Livent*, the Court of Appeal distinguished the cases previously recognizing a duty to supply a food product fit for human consumption because the scope of duty "does not extend to the franchisee's damages for pure economic loss… a duty aimed at protecting human health, was owed to the franchisee's customers not the franchisees… the type of injury claimed – economic losses arising from reputational harm – did not fall within the scope of any [existing] duty."[99]

The Ontario Court of Appeal approved the use of a full *Anns/Cooper* test when it upheld the motions judge in *Bonello v. Gores Landing Marina (1986) Ltd.* The motion judge had denied a duty of care in a third party occupier's liability claim and correctly applied the duty of care test summarized in *Livent*.[100]

Indeterminate liability was at issue in *Shah v. LG Chem Ltd.*;[101] a class action involving statutory damages under the Competition Act and unlawful conspiracy claim was certified despite the potential for indeterminate liability. After accepting the *Livent* majority's definition of indeterminate, the Court held that "concerns about indeterminate liability do not apply in the context of the statutory claim…. [and that] that the intentional component of the unlawful means conspiracy tort eliminates any concern for indeterminate liability."[102] In *DBDC Spadina Ltd. v. Walton*, the majority of the Court of Appeal relied on *Livent* to support their discretionary public policy approach to the use of identification theory in a case of commercial real estate fraud by directing minds of the company. The fraud was not attributed to the company.

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[93] 1688782 Ontario Inc. v. Maple Leaf Foods, (2018) O.J. No. 2417, 2018 ONCA 407 (Can.) (product liability); Lavender v. Miller Bernstien LLP, (2018) O.J. No. 4532, 2018 ONCA 729 (Can.) (auditing); Fairfield Sentry v. Price Waterhouse Cooper LLP, (2018) O.J. No. 4381, 2018 ONCA 696 (Can.) (accounting); Shah v. LG Chem. Ltd., 2018 ONCA 819 (Can.) (unlawful means anti-competition conspiracy); Bonello v. Gores Landing Marina (1986) Ltd., 2019 ONCA 127 (Can.) (tug of war game as to occupier's liability); Turcotte v. Lewis, 2018 ONCA 359 (Can.) (duty of care conceded); DBDC Spadina Ltd. v. Walton, 2018 ONCA 60 (Can.) (commercial real estate fraud); Wu v. City of Vancouver, 2019 B.C.J. No. 55, 2019 BCCA 23 (Can.) (municipal negligence) .

[94] *See e.g.* 1688782 Ontario Inc. v. Maple Leaf Foods, (2018) O.J. No. 2417, 2018 ONCA 407, ¶¶ 50-51. Lavender v. Miller Bernstien LLP, (2018) O.J. No. 4532, 2018 ONCA 729 ¶¶ 61,72 (narrow when pure economic loss)

[95] Shah v. L.G. Chem Ltd., 2018 ONCA 819.

[96] DBDC Spadina Ltd. v. Walton, 2018 ONCA 60.

[97] Fairfield Sentry v. Price Waterhouse Cooper. 2018 ONCA 696.

[98] *Maple Leaf*, 2018 ONCA 407.

[99] *Id.* ¶¶ 59, 62-64, 68.

[100] 2019 ONCA 127 ¶ 20.

[101] 2018 ONCA 819.

[102] *Id.* ¶¶ 45 – 47, 52, 57.

So far the Ontario Court of Appeal has heard two cases involving the auditing context and both reject an auditor duty of care. In *Lavender v. Miller Bernstien LLP*[103] the Court of Appeal unanimously overturned a motion judge's finding that the auditor of a securities dealer owed a duty of care to account holders for negligently auditing the Ontario Securities Commission annual registration renewal. The motions judge did not conduct a proper proximity analysis "in light of the Supreme Court's refinement of the *Anns/Cooper* test in *Livent*."[104] In *Fairfield Sentry Ltd. v. Price Waterhouse Cooper LLP*, the Court of Appeal upheld the dismissal of an action for negligent audit because no genuine damages were proven after applying the *Livent* method for calculation of damages associated with liquidation deficit. [105]

The British Columbia Court of Appeal has applied *Livent* once. In *Wu v. City of Vancouver,*[106] the lower court found that the City owed a duty of care to development permit applicants to approve permits in a reasonable time. The Court of Appeal overturned the creation of this novel private duty of care by applying principles from *Livent* to the proximity analysis and to public policy/indeterminate liability assessments.[107] *Livent* was also used to caution against applying existing duties in an overly broad interpretation and to contain them to their particular circumstances.[108] Overall, the application of *Livent* has been very good for defendants.

The variety of cases dealt with shows that *Livent's* legacy extends far beyond the auditing context. *Livent* joins *Anns* and *Cooper* as seminal cases on duty of care and it will figure into future duty of care analysis involving both interpretation of pre-existing categories and in assessments of novel duties. So far, the impact is to raise the bar for establishing tort liability by requiring full *Anns/Cooper* tests more often and restricting the application of previous precedents. By definition that means public policy considerations are in play more frequently, giving judges more opportunity to individualize and customize policy interpretation. The natural result will be less certainty in the law and a proliferation of litigation as lawyers are less able to apply previous precedents to new circumstances.

B. Auditor's Liability

Although not the priority of the Court, *Livent* contains important take-aways for the auditing community. In particular, the majority of the Supreme Court decided that:

1. *Hercules* establishes a recognized category of duty of care owed by an auditor to the corporate audit client in relation to negligent performance of a statutory audit.[109]

2. The two purposes of a statutory audit as defined in *Hercules* remain applicable today:

[103] 2018 ONCA 729.
[104] *Id.* ¶¶ 59-60.
[105] 2018 ONCA 696 ¶¶ 8, 15 *leave being sought* (not much direction because standard of review was overriding and palpable error).
[106] 2019 BCCA 23.
[107] *Id*. ¶¶ 50, 67, 69, 74, 78.
[108] *Id.* ¶¶ 80-81.
[109] Deloitte & Touche v. Livent, 2017 SCC 63 ¶ 58.

i. to protect the company itself from the consequences of undetected errors or, possibly wrongdoing, and

ii. to provide shareholders with reliable intelligence for the purpose of enabling them to scrutinise the conduct of the company's affairs and to exercise their collective powers to reward or control or remove those to whom that conduct has been confided.[110]

3. Increase in liquidation deficit (or deepening insolvency) is a reasonably foreseeable injury and consequence of a negligent statutory audit.[111]

4. Residual policy concerns and indeterminate liability do not apply to an auditor's duty of care in the statutory audit context.[112]

5. Liability for consequences of a statutory audit is confined to one year[113] for one claimant.[114]

6. Value of liability for a negligent audit, although potentially significant, will be the losses of one corporation.[115]

The Supreme Court is silent on several findings made by the Ontario Court of Appeal and therefore, those Court of Appeal findings can add to the guidance available to auditors. Important among these are the positions taken on whether the standard of care includes an obligation to resign, when the standard rises to one of "professional skepticism" and how an auditor may limit liability. On these issues, the undisturbed findings of the Court of Appeal are that:

7. An auditor's standard of care includes an obligation to resign.[116]

8. An auditor's standard of care includes a need to apply an objective attitude of professional skepticism when client information reveals repeated inconsistencies.[117]

9. An auditor may limit liability in the engagement letter.[118]

There are few particulars provided on the practical interpretation of obligation to resign or the level of inconsistency needed. Still, we can expect auditors to refine their engagement letters to specifically articulate the limited purpose for which the work is being done and the reliance that may be reasonably placed upon it. Specific uses will be negotiated with the client at the time of engagement. Seizing upon the dissent's distinction between information and advice,[119] we can also

[110] *Id.* ¶ 59.
[111] *Id.* ¶ 64.
[112] *Id.* ¶¶ 67, 75.
[113] *Id.* ¶ 69.
[114] *Id.* ¶ 70.
[115] *Id.* ¶ 72.
[116] Livent v. Deloitte & Touche 2016 ONCA 11 ¶ 277.
[117] *Id*. ¶ 301.
[118] *McGill*, *supra* note 49, at 22.
[119] Deloitte & Touche v. Livent, 2017 SCC 63 ¶¶ 86, 163, 171.

expect accountants to make use of the standard phrase, common among advisors: *This content is provided for information purposes only and should not be relied upon.*

The two auditing cases heard by the Ontario Court of Appeal should encourage the audit community as they demonstrate *Livent*'s narrow treatment of the auditor's duty recognized in *Hercules*, and resist expansion outside the statutory audit. Duty arising for auditing for other purposes such as securities regulation, remains unrecognized to date. The road to recognition requires a full *Anns/Cooper* test and therefore re-opens all available public policy arguments.

Also encouraging for the auditing community is that both *Livent's* majority and dissent looked to the corporate governance legislation for insight into the purposes of the statutory audit and any changes enacted in the ensuing 20 years since *Hercules.* No changes to purpose were identified. Given this process, there is an opportunity for the auditing community to lobby the government for legislative changes that distinguish *Hercules* and alter the purposes underlying the category's recognition.[120] *Rankin's* dissent would suggest that such a change in purpose would undermine the application of the previously recognized category.[121]

On a cautionary note, there may be a down side to the court's narrowing of previous duties to specific contexts and purposes. *Hercules* has been widely cited as authority for the principle that an auditor does not owe a duty to individual shareholders – this finding is now also confined to statutory audits. If investors/shareholders were to sue an auditor for individual investment losses stemming from negligent auditing work done for "the purpose of soliciting investors", I submit that neither *Livent* nor *Hercules* could be used to say such a duty had already been rejected. *Livent* examined the duty arising from the comfort letter in relation to the corporation only. A full *Anns/Cooper* test would be required for an investor action based on such a comfort letter. Auditors can expect a new round of litigation on this point with auditors repeating the indeterminate liability reasoning of the *Livent* dissent and identifying the availability of statutory cause of action in securities legislation as a residual policy consideration.[122]

In sum, despite what looks like a forty million dollar loss on the statutory audit duty, there is some very good news for the auditing community buried in the *Livent* outcome. Courts seem hesitant to extend duty beyond the statutory audit. Still auditors can expect plenty of litigation about specific contexts, purposes, indeterminacy and resignation and certainly another round with shareholders.

Conclusion

Livent will be enshrined within the *Anns/Cooper* duty of care test as one of the seminal cases on the analytic framework to be followed when assessing whether a duty of care is owed. Its long-term impact will be to narrow the application of exiting categories, trigger a full *Anns/Cooper* test more frequently and thereby increase civil litigation and uncertainty. Auditors can celebrate

[120] *Id.* ¶¶ 61-62.
[121] *Rankin*, 2018 SCC 19 ¶¶ 73-74.
[122] Deloitte & Touche v. Livent, 2017 SCC 63 ¶¶ 71, 176, 171; Securities Act, R.S.O., c S.5, s. 138.3 (1990) (Can.).

the containment of *Hercules* to statutory audit and reduced damages in light of a one-year temporal limitation but will also face expanded litigation related to purpose and reliance. *Livent* will live on.