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Ontario Court of Appeal Defines Boundaries in Auditors' Negligence Claims Post-Livent

In *Lavender v Miller Bernstein LLP* ("*Lavender*"), the Ontario Court of Appeal overturned an order granting summary judgment to a class of investors in a class action against the auditors of a defunct securities dealer. In doing so, the Court gave a detailed examination of the duty of care analysis as it applies in the wake of the recent Supreme Court of Canada decision, *Deloitte & Touche v Livent Inc* ("*Livent*").

Background

In *Lavender* the plaintiff, Barry Lavender ("Lavender") commenced a class action on behalf of all investors who had an investment account with Buckingham Securities ("Buckingham"). The class suffered significant financial losses when Buckingham was placed into receivership by the Ontario Securities Commission (the "OSC") for breaching its regulatory requirements to segregate assets and maintain sufficient minimum net free capital.

In seeking to recover their losses, these investors sought summary judgment against Buckingham's auditor, Miller Bernstein LLP, for negligently and falsely reporting that Buckingham's books were OSC-compliant in the three years prior to it going defunct.

There was no dispute over Buckingham's non-compliance with the OSC regulations. The question on appeal was what duty of care was owed by the auditor to the class of investors when executing their reporting functions to Buckingham and the OSC.

i. The New Starting Point: *Livent*

In *Livent*, the Supreme Court of Canada refined the application of the *Anns/Cooper* analysis for determining the scope of the duty of care owed by an auditor. Specifically, the court held that when determining whether there is sufficient proximity to establish a *prima facie* duty of care in cases of pure economic loss, there are two determinative factors: (i) the defendant's undertaking; and, (ii) the plaintiff's reliance. The extent to which these two considerations overlap – i.e. where the plaintiff's reliance falls within the ambit of the defendant's undertaking – will determine both the existence and the scope of the duty of care arising from the relationship. The court went on to hold

that only rarely will residual policy considerations negate this duty of care in this context.

In applying this duty of care analysis, the court in *Livent* found that not only did a statutory audit fall within a recognized category of proximate relationship (citing *Hercules Management v Ernst & Young*), but also that the losses suffered by investors as a result of the auditor's negligence were reasonably foreseeable, given Livent's reliance on its auditor's reporting for the purpose of overseeing its management decisions.

ii. The Fight: How to Apply *Livent*

In *Lavender*, the auditor took the position that the motion judge incorrectly applied *Livent*'s proximity analysis by not limiting the scope of their duty of care to the narrow scope of their undertaking. They claimed that their undertaking to Buckingham was limited to completing confidential Form 9 Reports for the OSC, and as such could only reasonably extend to Buckingham or the OSC.

Similarly, and again given the confidentiality of the reports, none of the class of investors saw or received the reports nor any representations about them, and so could not have relied on nor held any expectations of the auditors.

Lavender took the position that the auditor did in fact undertake to protect the class from the very harm that occurred. They pointed to the fact that Form 9 Reports were used by the OSC for the exact purpose of protecting investors, and the auditors would necessarily have known that the OSC would use these reports to exercise its investor protection functions.

iii. The Findings: No Proximity, No Duty of Care

The motion judge's ruling that a sufficiently proximate relationship existed between the auditor and the investor account holders was based primarily on two things: the evidence of correspondence between some of the class members and the auditor; and, the reasonable expectation of the class members that the auditors would provide accurate reporting to the OSC for the protection of their interests.

In overturning the motion judge's ruling, the Court of Appeal found that the motion judge erred in "stretching proximity beyond its permissible bounds" when considering the whole of the evidence.

First, the Court of Appeal found that the auditor's undertaking was primarily to Buckingham and to the OSC, and was insufficiently connected to the investors. The Form 9 Reports were confidential, the auditor made no representations about

them to the class members, and the majority of the class members were never even aware of the auditor's involvement. Ultimately, "the interposition of the OSC and Buckingham between the Auditors and the Class rendered the relationship between the parties too remote to ground a duty of care".

Second, the Court of Appeal emphasized that, in the absence of the reports themselves or any representation or knowledge of them, there was no reliance whatsoever on the part of the class members.

Third, the Court of Appeal identified two important factual errors made by the motion judge that informed their finding of proximity, namely: it was Buckingham and *not* the Auditor themselves that filed the Form 9 Reports to the OSC; and, the auditor did *not* have access to the names or accounts of the class members.

Finally, the court rejected Lavender's submission that the context and purpose of the particular statutory scheme under which the OSC required Form 9 Reports was enough to form a proximate relationship between the auditor and the class. The regulations here did not create a direct statutory duty of care, they simply required compliance reporting without any obligation to engage with or disclose those reports to investors. The court was unwilling to find that a relationship had been formed between the auditor and the class for the purpose of investment decisions and in relation to forms that they never saw.

iv. Implications

The Court of Appeal's decision in *Lavender* is significant in clarifying the limits in respect of the duty of care analysis post-*Livent* and confirms the central importance of the scope of an auditor's duty in the analysis. In emphasizing the significant scrutiny warranted when deciding whether to recognize a duty of care in a claim for pure economic loss and in tightening the boundaries of proximity for auditors, this decision will likely have a chilling effect on auditors' negligence claims.