

**Auditor Liability in Canada after  
*Deloitte & Touche v. Livent Inc. (Receiver of)***

**Anita Anand  
JR Kimber Chair in Investor Protection  
and Corporate Governance**

**University of Toronto**

**January 22, 2018**

# Background

- **2014:** Case first heard at the Ontario Superior Court of Justice.
- **2016:** Case heard at the Ontario Court of Appeal
- **December 20, 2017:** Supreme Court of Canada delivered its judgement.



Photo Source: The Canadian Press

# Introduction

- *Livent* raises new issues
- Heightens duties of the auditors in completing a statutory audit if either:
  - a) the corp is heading into insolvency
  - b) the corp is covering up fraudulent conduct.
- Implications for auditors as well as directors and shareholders.

# Main Holding

- Following *Hercules*, an auditor owes a duty of care to its audit client in respect of the performance of a statutory audit which Deloitte breached. Livent's injury was a reasonably foreseeable consequence of Deloitte's negligence.
- But this duty does not extend to other services or undertakings (including the solicitation of investors).
- Thus, Deloitte bears liability for the audit but not the comfort letter or press release.

# 4:3 Split

- **Rare:** 70-80% cases result in unanimous decisions; 5-4 splits 5% of cases (Alarie, Green)
- **Decision:** Both the majority and minority believed that a duty of care was owed under tort law.
- **Majority:** Deloitte performed a negligent statutory audit and breached its duty of care in tort law.
- **Minority:** No liability because Livent's loss could not causally be traced to the auditor's role. Reliance by s/h not proven. Also, policy would say no liability – unfair allocation of loss and indeterminacy...
- **Implication:** In future cases, there may be ample bases for finding no causal link between a negligent audit and the corporation's loss.

# Even Majority limited Deloitte's liability somewhat:

- Livent argued shareholders elected to invest in the corp in reliance on Deloitte's documents, which resulted in artificial extension in the life of the corp.
- SCC says no - Deloitte should not be held liable for damages related to the comfort letter and press release.
- Why? the corp failed due to a lack of corporate oversight – this would have occurred regardless of whether Deloitte issued a favourable opinion: reduced damages from \$84.8 to \$40.2 million
- But the reduction of damages is not the key consideration since FAULT WAS STILL FOUND AND SINCE the dollar amount will be offset by insurance.
- Implications for standards of professional conduct, and the enforcement of those standards through internal reviews, and those conducted by regulators.

# Implications for Shareholders

- **The Court thus observes the importance of shareholders while reiterating that no *per se* duty of care is owed to them.**

**“The shareholders’ capacity to oversee the conduct of Livent’s business was entirely dependent upon the statutory audit preceding that oversight. In particular, the shareholders’ reliance on that audit and the audit’s portrayal of the directors and their business ventures was a critical component of their oversight of management — which, we reiterate, was the very purpose in respect of which Deloitte undertook to act with reasonable care.” [Para 92]**

# Implications for Directors

- *Livent* does not alter directors' legal duties *per se*. But the decision raises red flags for:
- boards to oversee auditors and to listen to management when management raises concerns about the auditors; and for board conduct itself
- **The Court held that, “the very purpose of a statutory audit is to provide a means by which [the board’s] fraud and wrongdoing may be discovered.” [Para 103]**



# Protective

- The decision also protects directorial decision-making somewhat given the **SCC denial of Deloitte's contributory negligence claim.**
- SCC stated: "A negligent auditor cannot limit liability for its own negligence by attributing to the corporation the wrongful acts of its employees, such acts being the very conduct that the auditor undertook to uncover." [Para 109]
- Therefore, while circumscribing Deloitte's liability to the statutory audit and not the press release and audit opinion, the Court refused to limit Deloitte's liability for the statutory audit by allowing the defense of contributory negligence.

# Implications for Directors

- The duty of care owed by auditors to their clients for a negligent statutory audit is alive and well!
- Directors and management are somewhat protected given the denial of Deloitte's claim that Livent was contributorily negligent.



**Duty of Care**

Photo source: Business in the Community

# Implications for Auditors

- While the Court applied and upheld *Hercules*, this case differed on its facts as it marked the first time court has held that receivers can bring claim on behalf of creditors against the auditors.
- Citing directly from *Hercules*, the Court states that,  
“[i]n modern commercial society, the fact that audit reports will be relied on by many different people (e.g., shareholders, creditors, potential takeover bidders, investors, etc.) for a wide variety of purposes will almost always be reasonably foreseeable to auditors themselves. [Para 21]

# “Liquidation Deficit”

- In theory, the creditors fell within the range of protected parties in *Hercules* but *Livent* brought this point alive in practice given the facts of the case.
- **However, the case seems to allow suits against auditors in cases where the company (Livent) is experiencing a ‘liquidation deficit’. On the facts, this appears an extension of the law in Canada.**
- So, liability for auditors is potentially wider than under *Hercules* alone and we may well see more claims of this nature as a result.

# Impact on Costs, Decisions

- Impact on costs to audit firms which will in turn offset this risk through their errors and omissions insurance. This cost may in turn be passed to their clients, raising audit costs.
- Auditors may also become more judicious in their selection and retention of clients, especially those that carry a high potential risk of going into default.

# Part of a Trend?

## **India - Satyam Computer Services**

- PwC banned after it was accused of negligently auditing Satyam Computer Services, an IT company that artificially inflated revenue to the point where approx \$1 billion in revenue was fictional. (WSJ Jan 11, 2018)

## **Ukraine - PrivatBank**

- PwC banned after verifying misrepresented financial statements from the leading Ukrainian retail and commercial bank. (WSJ July 21, 2017)

## **Saudi Arabia - Mohammad Al-Mojil Group**

- Deloitte banned from audit work after working with a contractor that collapsed after over-extending itself during the country's construction boom. (WSJ June 20, 2016)

# Conclusion

*Livent* will have consequences for both auditors and their clients.

- Some may argue that the decision does not broaden the scope of liability that auditors will face: auditors completing a statutory audit for a corporate client owe a prima facie duty of care to their clients.
- Such a duty IS owed (*Hercules* and *Livent*).
- But the case also suggests that auditors may have an increased risk of liability when negligence in an audit fails to uncover fraud especially in the insolvency situation.