OBA Submission
Joint and Several Liability Consultation

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Submitted by: Carole J. Brown President Ontario Bar Association

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BAR ASSOCIATION
A Branch of the
Canadian Bar Association

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BARREAU DE L'ONTARIO
Une division de l'Association
du Barreau canadien

The response of the Ontario Bar Association (OBA) to the Law Commission of Ontario Consultation Paper, April 2010

OBA's RECOMMENDATION

The OBA recommends that no change be made to joint & several liability as it pertains to Auditors.

THE OBA WORKING GROUP

This submission has been prepared after consultation with the Ontario Bar Association working group established to address the issues contained in the Law Commission of Ontario Consultation Paper on Joint and Several Liability. Members of this working group come from the Civil Litigation, Insurance Law, Business Law, Municipal Law, Law Practice Management, Young Lawyers' Division and Public Sector Sections. The working group also included members from OBA's Board of Directors (its immediate Past President and Vice President), members from large, medium and small firms, members both from in and outside Toronto, and members with experience in business, professional liability, insurance and negligence law.

Regardless of any individual member's areas of practice, geographic location, or the size of the firm from which the member came, the working group spoke unanimously on this subject.

INTRODUCTION

The LCO position paper asks whether the OBCA should be amended by adding similar provisions to those added to the CBCA, the effect of which would mean that the liability of auditors would be several. Joint and several liability, as imposed by the Negligence Act, would no longer apply. Several models are proposed.

Groups representing financial advisors, and auditors in particular, have argued that the joint and several liability model should no longer apply to their conduct, but be replaced by a proportionate liability scheme. The arguments auditors advance in support of restricting their liability are:

> a) in cases arising from investment or other commercial losses, the auditor is usually one of a few (if not the only) insured party or party with assets. Therefore, the auditor pays a disproportionate share of the loss, including that of the mainly liable, but insolvent, party;
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> b) because of unlimited personal liability, auditors may have personal assets exposure, beyond available insurance;
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> c) this disproportionate liability exposure deters young people and/or small accounting firms from entering the audit field and/or drives them to jurisdictions like the U.S. where there is a more favourable liability regime;

d) liability insurance is either not available in sufficient amounts to cover the disproportionate liability exposure and/or too expensive;

f) the joint and several liability of auditors creates indeterminate liability, thereby exacerbating liability and insurance concerns;

g) this disproportionate liability exposure is 'unfair' to auditors.

The OBA's position is as follows:

a) The LCO's consultation paper applies only to auditors and there is no evidence to support limitations to their liability, not enjoyed by other Defendants;

b) The arguments put forward by those advocating for proportionate liability are not supported by reliable evidence or persuasive policy analysis justifying reform for auditor's liability. Rather, the arguments in support of limiting auditors' liability are positional, charged with rhetoric, and reflect belief or 'received wisdom';

c) The existing law of joint and several liability is well understood and supported by a large volume of case law. Businesses, litigants, courts and insurers understand its application. They can plan and budget for known risks. Introducing a proportionate liability scheme would introduce an element of unpredictability and replace certainty with uncertainty. Therefore, the burden to justify a change from well-established law should be on those that propose it;

d) The impact of the proportionate liability model introduced into the OSA and CBCA has not been sufficiently studied to measure its impact on consumers, investors, financial advisors or the capital markets.

An Historical Perspective[1]

The social policy behind joint & several liability can only be understood in its historical context. As well, joint and several liability must be looked at in a much broader context, as only one component of the law of negligence. An understanding of the application and impact of the duty of care analysis is fundamental to any review of the joint and several liability model.

Limiting a Plaintiff's ability to collect all or part of a judgment from any one tortfeasor who is jointly liable for the same damage is a fundamental change to the Common Law of Ontario. It is NOT, as supposed, something that came into being with the *Negligence Act.*

At Common Law, a Plaintiff had the right to collect the full measure of his damages from any tortfeasor whose actions caused the damage. In other words, at Common Law, if

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[1] See, generally, Cheifetz, David, Apportionment of Fault in Tort, Toronto: Canada Law Book, 1981.

there were several tortfeasors who caused the Plaintiff's loss, the Plaintiff -could sue any one tortfeasor and recover 100% from that tortfeasor.

The principle of joint & several liability among all tortfeasors who cause the Plaintiff damage concurrently (after deducting the Plaintiff's contributory negligence), and the separate right of tortfeasors to seek contribution from each other for amounts paid in excess of the paying Defendant's liability, however, were brought into being by the *Negligence Act,* S,O. 1930, c. 27.

The *Negligence Act* is a remedial statute which ameliorates the Common Law's harsh rules. Some of these included:

- A Plaintiff's fault for his own losses, no matter how small, was an absolute defence to the tortfeasor regardless of the tortfeasor's own fault;

- Joint tortfeasors (tortfeasors working with the same end) were liable each for the full damages they caused, jointly and severally. The Plaintiff could recover from one or all, although the Plaintiff could not get double recovery of his damages;

- Concurrent tortfeasors (tortfeasors who, by coincidence cause the same damage to the Plaintiff, were liable each for the full damage they jointly cause (liability *in solidum*), and severally liable for separate damage they each caused. The Plaintiff could recover from both to the extent of the damages jointly caused, but only from each for other damages each tortfeasor caused. This liability reflected the principle of causation;

- There was no right of contribution between tortfeasors.

Therefore, at Common Law, a person injured by joint tortfeasors could collect fully from any one tortfeasor, or a combination of tortfeasors, but the tortfeasor executed against could not collect anything from other liable tortfeasors.

Procedural absurdities followed. A Plaintiff could sue all joint tortfeasors in one action, and execute against any. Alternately, he could sue each joint tortfeasor separately and receive a judgment against each for the entirety of the loss.

The *Negligence Act's* provisions, and the concomitant Rule changes, allowed Plaintiffs to sue all tortfeasors in one action, and removed the absolute bar to suit posed by contributory negligence.

The *Negligence Act* maintained the Common Law's principle that each Defendant was responsible for 100% of the loss it caused the Plaintiff. It allowed a Defendant to seek contribution from other liable Defendants. Since the Common Law prohibited double recovery, the Act required the Court to apportion relative fault between all liable parties so that, among them, the Defendants could apportion the damages according to their fault.

What the auditors want to change is not the statutory right of contribution or indemnity among tortfeasors as created by the *Negligence Act*, but the older, common law principle that a Plaintiff has the right to recover its full damages from any tortfeasor who caused its damages, leaving the Defendants to bear the risk that another of the Defendants is insolvent.

A Principled Approach is Required

In the OBA's view, a change such as that proposed by the auditors is a change to the Common Law and to remedial legislation that would derogate from existing legal rights. Accordingly, such a change should not be undertaken unless there is a clear need for the change, substantiated by clear evidence, and after broad consultation.
There is no clear need for the change proposed by the auditors. As indicated above, the current state of negligence law requires any Defendant who caused damage to the Plaintiff, to be responsible for 100% of the damage caused, since, without his negligence the damage would not have been caused. If there are multiple Defendants who concurrently cause the damage, as between them, they can apportion the damages (net of contributory negligence) among them.

The purpose of this was NOT to limit the liability of any one joint tortfeasor to the Plaintiff. Any liable tortfeasor who caused the Plaintiff's loss was still responsible for the total loss. The advent of joint & several liability, however, allowed any joint tortfeasor to share that liability with other liable tortfeasors.[2] At page 16 of his paper, Debenham writes:

> Concurrent liability means that the defendant is 100 per cent at fault for causing the loss to the plaintiff, because without the particular defendant's individual wrongdoing the plaintiff would not have suffered a loss at all. It is therefore not accurate to say that each of a number of concurrent wrongdoers are only partly responsible for the plaintiff's loss for liability pertains to a particular defendant if, and only if, the plaintiff can establish that but for this particular defendant's negligence, the loss would not have occurred at all. In all cases, the causal responsibility of each wrongdoer extends to the whole of a plaintiff's loss. Each wrongdoer is liable on the basis that the plaintiff has been able to establish that his or her entire loss was caused by the defendant in question, not just 1% or some other proportion. In the case of an auditor, or other accountant providing an assurance that financial information is not materially misleading, but for the auditors act or omission in giving a false assurance due to their lack of care, the user would not have relied on the preparer's financial information and no loss would have resulted. Put another way, to the extent that a purchaser of a house is relying on a building inspector to catch the builder's defects and an auditor to catch errors in financial information, and to the extent each fails to do so through their own negligence, the purchaser has suffered the entire loss in question because if the inspector or auditor had acted properly, no loss would have ensued. If it were otherwise, the plaintiff would lose their case against the inspector or auditor outright. While as between the watchdog and the company building the house or preparing the financial statement the watchdog may want to lay some of the blame at the originator of the faulty house or information, that is a matter between them and not the innocent plaintiff who relied on the inspector or auditor. As far as the law is concerned, the plaintiff reasonably relied on the auditor or inspector such that liability should pertain. The loss distribution between the auditor and the management truly is an entirely independent matter between them only and should not serve to reduce the plaintiff's claim against

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[2] Debenham, D., "An Auditor's Most Important Problem?", 5 #4 Comm. Lit. Rev. 41 (2007).

> those specifically hired to protect them. If *in solidum* liability actually resulted in an auditor being held liable for more damages that he or she caused due to lack of due care that would indeed be unjust, but that is not what *in solidum* liability does. One cannot be partly negligent and be held liable. One is either negligent or not negligent, and to be negligent one has to have both been careless and have caused 100 per cent of the damage assessed by the court before any liability pertains in the first place. It is only when there is more than one person who contributes to the same loss that a defendant gets the opportunity to share that loss with another co-defendant on the basis of comparative responsibility between co-defendants.[3]

The question posed on page 10 of the Consultation Paper is an important one.

> "Is there a relationship between the substantive proof of negligence against an auditor and recovery by way of joint and several liability?"

It is the view of the OBA that there is indeed a relationship between the substantive proof of negligence and the application of the joint and several model. Policy considerations, many of which are at the heart of the debate over proportionate liability, are addressed under the duty of care analysis.
Under the duty of care analysis, negligence law, as it currently stands, effectively addresses the arguments put forward in support of a proportionate liability scheme.The OBA believes that the limits on liability imposed by the duty of care, the class of those to whom the duty is owed, the breadth of that duty, foreseeability and causation, suitably limit the liability of auditors by rules that are relatively clear and understood, such that auditors can plan their business.

The analysis of legal duties of care must follow the approach outlined by the Supreme Court of Canada following *Anns v. Merton*.[4] Professional advisors are not responsible for the Plaintiff's losses unless there is a relationship of proximity between the parties, there are no persuasive public policy reasons to negate a duty of care, and the losses are foreseeable to the Defendant. This test provides three layers of protection to professional advisors to avoid inequitable or undue exposure to liability.

The absence of a duty of care excuses a tortfeasor for any damages its acts may cause. The Court may find no duty between the Plaintiff and Defendant exists because there is insufficient proximity in the relationship between the Defendant and the Plaintiff. Even if there is sufficient proximity, the Court may still "negate" that duty where there are compelling policy reasons to do so.

The Plaintiff must demonstrate the required proximity to give rise to a duty of care. For there to be a duty of care the relationship between the Defendant and the Plaintiff must be sufficiently close and direct as to give rise to a duty based on things like expectations, representations, reliance and other interests involved.[5] This flows from the principles enunciated in *Donoghue v. Stevenson* where the court describes such relationships as including: "such close and direct relations that the act complained of directly affects a

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[3] Debenham, D., supra, at p. 16 (internal footnote deleted).

[4] [1978] A.C. 728, Kamloops (City of-) v. Nielsen, [1984] 2 S.C.R. 2 and Cooper v. Hobart, [2001] S.C.C. 79.

[5] *See Fullowka v. Pinkerton's of Canada Ltd.*, [2010] S.C.C. 5, at paragraph 26.

person whom the person alleged to be bound to take care would know would be directly affected by his careless act".[6] -Where there is a relationship of proximity, the Defendant is charged with the duty to take reasonable care to protect others from the negative effects of his actions.

Even where a proximate relationship between Plaintiff and Defendant exists, policy considerations can negate a duty of care. An important policy consideration that may operate to negate a duty of care is concerned with the potential to expose Defendants to indeterminate liability.

Thus, policy considerations may operate to negate a duty of care thereby relieving the tortfeasor of any liability for negligent conduct. Policy considerations, in part, will be concerned with the benefits of imposing liability for negligence balanced against those favouring immunity. To the extent that imposing liability has an undesirable effect on society sufficient to outweigh the advantage of imposing liability, the duty of care analysis will shield the wrongdoer from responsibility. Auditors will enjoy immunity from their negligent preparation of financial reports where, on policy grounds, the Plaintiff does not belong to that class of persons who are reasonably expected to rely on the reports, or where the statements were used for some purpose other than that for which they were prepared.[7]

In our view, altering joint & several liability of auditors and financial advisors will negate or diminish the public policy aspect of the duty of care analysis. The duty of care analysis is sufficient to provide immunity for auditors where public policy justifies immunity. In the absence of a reason to negate the duty of care, however, auditors should be held liable, as any other wrongdoer, for the full extent of the loss caused to those who the auditor knew, when performing the assignment, might be detrimentally affected by the substandard performance of their duty. Foreseeability requires that the damage to the claimant was something the potential tortfeasor ought to have seen as being likely to flow from his actions.[8]

The duty of care imposes on each Defendant who causes the Plaintiff's damage, the obligation to make restitution, through damages, irrespective of another tortfeasors' possible liability. The Common Law rules against double recovery require that, where there are multiple liable Defendants who cause the Plaintiffs' damage jointly, that they have a right to apportion liability between them.

Causation also assists the auditors. The law of causation requires the Plaintiff to prove, on a balance of probabilities, that the negligence of the Defendant caused harm. This involves the application of the "but-for" test. To recover damages the Plaintiff must show that but for the negligence of the Defendant the loss would not have occurred. The fact that the Plaintiff's loss may be distributed over a number of liable Defendants does

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6 [1932] A.C. 562 (H.L.), at page 581.

7 See *Hercules Managements Ltd. v. Ernst & Young*, [1997] 2 S.C.R. 165, at paragraph 37**.**

8 See Fullowka, supra.

not diminish the finding that but for the negligence of each wrongdoer, the loss would not have been incurred. The entirety of the Plaintiff's loss can be attributed to each wrongdoer.

The Insurance Crisis

The auditors argue that joint & several liability has caused an insurance crisis. The argument is that because auditors pay a disproportionate share of damages, insurance is not available in sufficient amounts, and at a reasonable price, thereby exposing the auditing firms' and the auditors' personal assets to seizure.

Before *Hercules Management v. Young*, auditors were saying that this 'insurance crisis' was caused by liability following the *Hedley Byrne* principles. Their focus, post *Hercules* has shifted to blaming joint & several liability.

As one author puts it, liability under the *Anns* test is so restricted that the auditor is only liable to someone in a relationship equivalent to contract with the auditor, and who the auditor not only knew would be relying on the audit but for whom the audit was conducted, knowing that that person would be relying on it and the audit was planned with that purpose in mind such that the auditor accepted responsibility to that person as part of accepting the audit engagement. As a result we ought to require firm evidence in support of any allegations of an "insurance crisis".[9]

There is no evidence of this "insurance crisis". The evidence is to the contrary. At the October, 2009 Round Table LCO meeting, Jordan Soloway, Vice-President of Claims, and General Counsel for Munich Reinsurance in Canada, and Vice-President of Claims for Temple Insurance Company, advised the Round Table participants that this argument was not correct. E&O premiums in Canada were not inflated by joint & several liability rules. Rather, they were depressed by the abundance of insuring capacity coming into the Canadian market.

There is NO Evidence Supporting the Call for Change

No evidence was offered to support the arguments in favour of limiting joint & several liability for auditors either at the October, 2009 Round Table discussions, or today.

For instance, it is advanced that there are fewer small and mid sized accounting firms in Canada performing audits of financial statements. It is alleged that this phenomenon is the result, in some measure, because of unrestricted joint & several liability. There was no evidence to support this statement. Even if the statement is true, there was no evidence that the move out of audit functions by mid and small accounting firms was due to unrestricted joint & several liability, as opposed to other factors such as the post September 2008 economic slump or changes in the audit/accounting world after the Enron/Arthur Anderson fiasco.

[9] Debenham, D., "An Auditor's Most Important Problem?", 5 #4 Comm. Lit. Rev. 41 (2007).

The proposition that fewer young accountants are entering the audit field because of unrestricted Joint & several liability, in whole or in part, is equally unsubstantiated.

This Request is Not New

The position advanced by the auditors is not new. It has been the subject of several comments. Examining the implications of the various liability models, and using auditors for illustration, David Debenham, a prolific writer on the subject, and a member of OBA's working group, proposed that the analysis ought to include consideration of the following factors[10]:

a) Generally, the auditors percentage of liability is a material part of the loss;
b) This issue will not arise if all of the Defendants are solvent;
c) The auditors generally are in a better position than the Plaintiff to determine which parties are proper parties to the litigation;
d) Auditors will be liable only to those who they knew or should have known, reasonably, would rely on audited statements made in accordance with applicable standards of care;
e) Auditors are aware of the importance of the accuracy of financial statements to investors, in particular, and to the integrity of the capital markets generally;
f) There is no reliable evidence that audit costs or the availability of audit services will improve under the proportional liability model;
g) Trends in other jurisdictions to adopt proportionate liability models, even if deemed appropriate in those jurisdictions, have little application to the Canadian context when regard is had for the application of the law of negligence and, in particular, the duty of care analysis and the approach of courts to establishing standards of care;
h) The legal test for causation, the but-for test, on a principled basis, supports a joint and several liability model over a proportional liability model;
i) There is no compelling justification for disturbing the joint and several liability model involving litigants other than auditors, and no justification for distinguishing auditors from other litigants;
j) Negligence law has a deterrent effect, and corrects behaviour. Limiting the joint and several liability model hampers the ability of negligence law to attribute responsibility equitably. It undermines the deterrent effect of negligence law a method of regulating behaviour.

We have addressed many of these criteria, already. A few merit further comment.

1% LIABILITY: Auditors say that when they are found to be 1% liable, the often pay 100% of the damages, thereby becoming guarantors of the judgment. There is no case where an auditor was held 1% responsible for the loss and paid the entirety of the claim.

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[10] See D. Debenham, "One Percent at Fault, One Hundred Percent Liable to Pay" A Look at Accountants' Solidary Liability in Canada", 8, #4 Commercial Litigation Review 1 at 6 (November, 2010, forthcoming)..

Generally, if auditors are liable, their share of liability is substantial. Auditors argue that they are the only, or frequently the only, insured or solvent party and pay the liability of others. This proposition is advanced without evidence to support its truth.

AUDITORS' ABILITY TO MITIGATE: Through due diligence, auditors may be able to mitigate the risks associated with the potential liability they are exposed to, and are in a better position to do so than those who rely on their work product. Auditors are in a better position to evaluate the risk in the context of the auditing assignment itself and/or determine the likelihood of insolvency of others. Rather than force clients to bear the burden of loss resulting from unreliable economic data, the auditor ought to build in the apparent risks of the assignment by pricing the job according to risk, arranging for the client to post needed security, qualifying their involvement in the assignment, or declining to take the assignment on altogether. Each of these is may be a better way to protect all parties involved rather than visiting the burden of these risks on those least liking to be aware of them.

ACCURATE FINANCIAL STATEMENTS AND THE INTEGRITY OF THE CAPITAL MARKETS: In spite of the auditor's awareness of the importance of their assignment to shareholders, corporations, creditors, investors and others, it is not in every case that liability will follow from negligent performance of these assignments. To the extent that there may be liability, the auditors have incentive to improve their skills, guard against loss exposure, and plan for them if they cannot be eliminated.

OSA AND CBCA CHANGES HAVE NOT BEEN STUDIED: The arguments made by those advocating for a proportionate liability model for financial advisors claim that under the current model auditor services are more scarce, -insurance premiums will be unaffordable, professionals will be discouraged from working in the field, and, costs will rise to unsustainable levels.

As indicated above, there is no evidence to support these assertions, and in some cases, the evidence is to the contrary. The effect of the previous changes to the OSA and CBCA on these issues has not been demonstrated. In these circumstances, these claims ought not to form the basis of reform of negligence law.

OTHER JURISDICTIONS HAVE REJECTED PROPORTIONATE LIABILITY FOR AUDITORS: In Canada, we have already addressed auditors' liability concerns by allowing them to use limited liability partnerships and limited liability corporations, which is not the case in other commonwealth jurisdictions.

In other jurisdictions, as part of Sarbanes-Oxley type legislation, proportional liability has been accepted, but only as part of a trade-off for the increased liability imposed by statute.

The call for proportional liability had been instigated and coordinated by the international audit firms and their domestic associations. Law Reform commissions throughout the Commonwealth have almost unanimously rebuffed any suggestion that the present rule

should be replaced. The English Institute of Chartered Accountants made the same arguments in 1995 in "Auditors' Liability, The Public Interest Perspective" and were rebuffed by the English Department of Trade and Industry Feasibility Investigation of Joint and Several Liability, that looked into whether proportional liability was even worth another look, published the following year.

WHY CREATE A SPECIAL CLASS OF DEFENDANTS:
Why are auditors entitled to special treatment? Absent empirical evidence to suggest that auditors are a special case, there is no reason to treat them as such.

Allowing auditors to be protected by proportional liability, while not so protecting others involved in the IPO or other case in which the auditor is named (such as lawyers, accountants not providing auditing advice, risk managers, brokers or insurers) makes no sense.

The OBA Working Group

Jamie Trimble	Co Chair
Richard Halpern	Co Chair

Lee Akazaki
MaryEllen Bench
David Boghosian
Mark Coleman
Pascale Daigneault
David Debenham
Chris Garrah
John Lea
Sandra MacKenzie
Guillermo Schible