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Indirect Negligence: Recent Case Study Involving an Auditor’s Liability to Defrauded Investors

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One person may owe another a duty in a host of different ways. There may be a contractual, an agency, or a fiduciary relationship between the parties, to name a few of the more obvious examples. A person also owes a duty (of care) to not negligently or fraudulently misrepresent facts to those with whom he or she has a special, direct relationship. In some cases, a person even owes a duty to a party with whom he or she had little or even no direct relationship. The case of Lavender v. Miller Bernstein provides one such example of this type of liability for negligence.

Lavender involved an Ontario securities dealer (Buckingham Securities; hereafter just “Buckingham”) which held investments of over 1,000 retail clients. The securities regulator placed Buckingham into receivership when it discovered that the company, among other wrongs, appropriated its clients’ assets and used same for its own purposes. Buckingham admitted to the wrongdoing, which cost its clients $10.6 million. The forms filed by Buckingham to the regulator during the material times were audited by the accounting firm of Miller Bernstein. The lawsuit before the Court was a class action brought by the investors against the accounting firm.

The specific matter before the Court, brought by way of a summary judgment application, was the liability of the firm to the investors. That question focused on the critical issue of whether the firm owed a duty of care (the fundamental, threshold issue in negligence law), which could be broken down to 2 sub-issues: 1) whether the firm and investors had a relationship of sufficient closeness and 2) whether the imposition of a duty would create indeterminate liability.

Regarding the first sub-issue, the Court found that there was sufficient closeness, or foreseeability and proximity, between the firm and investors. Even though the investors never saw and probably did not even know at the time about the regulatory forms audited by the firm, the latter “as a matter of simple justice” had an obligation to be mindful of the plaintiffs’ interests when auditing and filing the forms with the regulator. The firm understood, the Court found, that the forms were used by the regulator to police the dealers and protect their investors, finding (para 21): “If the [forms] indicated a breach of the [regulatory requirements], the [regulator] would intervene. If the [firm] was negligent in its audit and filed false [forms], causing the [regulator] to believe that the securities dealer was in compliance with the regulatory requirements when the truth was otherwise, monies invested by clients of the securities dealer could well be lost. In short, the defendant […] well understood the consequences to ‘its client’s clients’ […]”

The Court had little difficulty finding, in respect to the second sub-issue, that there was no serious concern about indeterminate liability, relying on the well-established legal principle that indeterminate liability will not be a concern where the auditor knows the identity of the plaintiff and where the defendant’s statements are used for the specific purpose for which they were made. In the case at bar, the firm knew the names, addresses, and specific financial positions of Buckingham’s clients at the time of its audits (of which there were three). It was also required, between audits, to stay informed of any major changes to
Buckingham’s business. The statements were audited for the purposes described in the preceding paragraph.

Ultimately, the Court summarily held that the accounting firm did owe a duty of care to the investors and was in fact negligent in its auditing of Buckingham’s regulatory forms. The damages owed to the investors by the firm on account of the latter’s negligence was ordered to be determined in a subsequent proceeding.

**Invitation for Discussion:**
Our litigation lawyers are skilled in negligence law. If you would like to discuss this blog in greater detail, or any other business litigation matter, please do not hesitate to contact Mohamed Amery or one of the lawyers in the Business Litigation Group at Shea Nerland LLP.

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