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DELOITTE V LIVENT: THE SCOPE OF AUDITOR NEGLIGENCE

by Bonnie Fish and Kyle Kuepfer


Bonnie Fish
Partner

t: 416.941.8808
bfish@foglers.com


Kyle Kuepfer
Associate

t: 416.864.9394
kkuepfer@foglers.com

In *Deloitte & Touche v Livent Inc. (Receiver of)* 2017 SCC 63 the Supreme Court of Canada revisited the scope of auditor liability for negligence. The Supreme Court held Deloitte liable to Livent's shareholders for negligently audited financial statements but not for offering documents prepared in connection with a public debenture underwriting. Since the offering documents were prepared to help Livent attract investment, the Supreme Court reasoned that Livent's shareholders were not entitled to rely on them for other purposes, including oversight of Livent's management.

The Facts

Two of Livent's directors manipulated the company's financial records to make it appear more solvent than it was. Livent engaged Deloitte as its auditor, who performed the following services from 1997-1998:

- the preparation and approval of a press release and comfort letter circulated in advance of a public debenture underwriting in October 1997 (the "**Offering Documents**"); and
- the preparation and approval of Livent's audit for 1997, which was completed in April 1998 (the "**Audit**").

While performing these services, Deloitte identified irregularities in Livent's accounting. Although Deloitte raised concerns with Livent, Livent denied the irregularities. Deloitte was forced to either resign or continue to provide services which it knew might be inaccurate. Deloitte chose to continue. As a result, the Offering Documents and Audit contained inaccuracies. In November 1998, the accounting irregularities were discovered by new management, who retracted the Audit and issued restated financial reports. Livent went into receivership in September 1999.

The Lower Court Decisions

Livent's receiver commenced an action against Deloitte alleging that Livent's shareholders relied on the Offering Documents and the Audit to their economic detriment. The receiver argued that if Deloitte had reported the irregularities when it first discovered them in the fall of 1997, Livent would have gone out of business earlier, and could not have continued raising capital and spending money which decreased the company's net worth.

The trial judge largely agreed with Livent, holding that Deloitte breached its duty of care to Livent's shareholders by continuing its retainer and preparing the Offering Documents and Audit. Livent's reliance on the representations in these documents resulted in an artificial extension of the company's solvency. The trial judge held Deloitte liable for $84 million, being the difference between the value of Livent on the date Deloitte should have resigned, when the Offering Documents were provided, and Livent's value on the date of receivership (less 25% for contingencies). The Ontario Court of Appeal agreed with the trial judge.

The Supreme Court Decision

The Supreme Court allowed Deloitte's appeal in part. The Supreme Court agreed with the lower courts that Deloitte was liable to Livent's shareholders for its negligent preparation of the Audit. The Court found that the Audit was performed to protect Livent from undetected accounting errors and assist Livent's shareholders to review and oversee management. Deloitte's negligence in conducting the Audit impaired Livent's ability to oversee management and exposed Livent to "reasonably foreseeable risks, including 'business losses' that would have been avoided with a proper audit" (para 65). Economic loss caused by the shareholders' inability to hold management accountable for these irregularities was a reasonably foreseeable consequence of the negligent Audit. Consequently, the Supreme Court found Deloitte liable for the Livent's decrease in value after the Audit was performed (approximately $40 million).

However, the Court did not find Deloitte liable for damages arising from the preparation of the Offering Documents. Since the Offering Documents were prepared to solicit investment from third party investors, the Court held that Livent's shareholders could not have reasonably relied on them for other purposes, including management oversight. The Court held that because "...Livent had no right to rely on Deloitte's representations for a purpose other than that for which Deloitte undertook to act, Livent's reliance was neither reasonable nor reasonably foreseeable" (para 55). Consequently, the Court held that Deloitte was not liable for the decrease in Livent's value for the period between the delivery of the Offering Documents in October 1997 and the preparation of the Audit in April 1998.

Deloitte v. Livent is consistent with earlier Supreme Court case law respecting auditors' negligence. Professional opinions are unlikely to create liability unless they are relied upon for the purposes for which they were prepared. Based on this case, auditors and other professionals should clearly define the scope, intended use, and intended recipients of their opinions to minimize their exposure for unanticipated reliance on their work.